

On Wednesday October 22 I visited JACAM—the production chemicals headquarters for Canadian Energy Services, and it's located in a 35 acre field at the edge of the very small town of Sterling Kansas...truly the middle of nowhere.



I'm going to tell you about the trip, and a few of the specifics that got me excited—*like their new fracking fluid that uses nanotechnology—it went through a 12 well test with a huge independent, and results showing 18-33% increase in oil flow over the IP30.*

I spent six hours touring the entire complex and speaking with senior and middle management at length on a sunny, breezy Wednesday morning. I was one of a group of 20 investors from Calgary, Toronto, Chicago and New York.

JACAM is in a field – A Field of Dreams for Investors. Inside JACAM's many buildings—with more going up all the time—industry's dreams are being realized. And that means investor's dreams—of continual profitable growth—are also coming to fruition.

JACAM is a production chemicals company. They make molecules; they make basic chemicals right there. They use a series of high and low temperature reactors to do that. Then they blend it there on site as well, in a liquid or solid form, so each chemical mix does what they want it to do. They told me that most of their competitors don't do that; they farm out a lot of the basic work and they are like GM or Ford and just assemble and market it.

These chemicals have to be constantly re-applied to oil and gas infrastructure because oil, gas, other hydrocarbons, water and bacteria are all very corrosive. It's the produced water that is naturally underground that creates most of the problems that require chemical solutions. This would be things like formation of bacteria, scale, hydrogen sulfide (H₂S) and corrosion (pitting). So this is a long term, recurring revenue stream over the entire life of the well.

This steady, reliable cash flow is what made the Market TRIPLE the share price for CEU within one year of buying JACAM.

My Key Takeaways Were:

1. Management are great PEOPLE. Clearly kindhearted and a **cohesive team**. I was really impressed at the passion and verve and vision they had in marketing current JACAM products, and challenging founder Gene Zaid to come up with new solutions. They really think they can do anything.
2. *As fast as they can hire the right people, business is waiting.*
3. Creativity and innovation is their calling card; they don't charge much if any more at all for their premium products. They win new business because of the speed in which they deliver solutions to clients. They don't price products by how much they're saving the client.
4. A couple of the products have MONSTER untapped potential, like their patented SuperCor, the corrosive inhibitor that can be used both in production well piping and midstream pipelines. This product is **dramatically** undersold. I think their new fracking fluid could also be a killer app. They have the only oil soluble H₂S scavenger, which is now a Top 3 product out of 400 and sales are still growing like a weed.

5. I was a little surprised to hear there isn't a lot of communication or integration between the drilling fluids group—who work for the 14 days a well gets drilled—and the production chemicals group, who work for the next 14-40 years of the well's life. Different customer; i.e. not different companies, but different specializations within those customers that are VERY different sales. I thought there would have been a lot more referrals between the two, but not really. That will improve a bit with time and more people, but the two businesses are more separate than I would have thought.
6. There is however a lot of decentralized decision making that makes them so entrepreneurial.

These tours are so valuable because you get so much more colour on the business being there, as opposed to listening to quarterly conference calls.

THE BIG PICTURE – MANAGEMENT and ENTREPRENEURSHIP

The key Big Picture item is--you want to get a sense of management; the character and demeanor (I learned my lesson on that earlier this year ;-)).

I met JACAM founder Gene Zaid, who lives in Sterling. You quickly realize what a kind man he is by the way he speaks to his senior and junior employees, and his desire to see everyone included at every step in the tour. As CEO Tom Simon pointed out, they were looking for people who are creative, tell the truth and work hard.

Gene and his team certainly embodied that. One amazing part of this tour was that Gene and Tom had flown in several CEOs of recent acquisitions, to talk about why they agreed to become part of the CEU fold. They walked around with us all morning, from building to building, answering technical and marketing questions. So the depth of senior management was incredible.

My key takeaway on that question—why agree to be bought by CEU—was the entrepreneurial culture. They all spoke of having their own dreams—the perfect

product in their niche, on time, and in perfect and consistent quality. And there was no other group out there who could deliver what they asked anywhere near as fast. And in some cases they knew nobody could deliver at all.

One of these CEOs spoke to how he wanted a clay based drilling mud with certain characteristics—anodized or quanterized doo-hickey thing-a-ma-bobs. I think it gave water-based mud some of the same characteristics as oil-based mud. Gene and the JACAM team knew how to do it already, but they vertically integrated the base materials, built a huge new production facility in the corner of the property and made it themselves—in the last six months. In any of the larger competitive companies to JACAM, that's a 3-5 year process they say. AND they are able to produce a slightly superior product with better than industry margins at the same price as competitors.

Now, I'm just going to flow with this idea for a minute. During a lunchtime Q&A it came out that even a lot of the specialized chemical business is commoditized.

But where CEU/JACAM consistently wins new business, or worms their way into more business with existing clients—is how quickly they can solve a problem for the customer with their chemistry solutions. Then they get to sell the rest of the commoditized chemicals too.

One investor asked them to name a brand new customer they just started doing some business for in the last six months. And they rhymed off four of the largest independents in the United States—like boom, boom boom and boom.

(And they already do almost all the drilling fluid work for EOG in Texas. EOG is arguably the best producer in the business, in context of trying new things and improving well productivity; they were the pioneers of the short wide frack vs the old long skinny frack. I think that's a helluva calling card.)

The last two pages speaks volumes to their entrepreneurial culture being the *raison d'être* of their success.

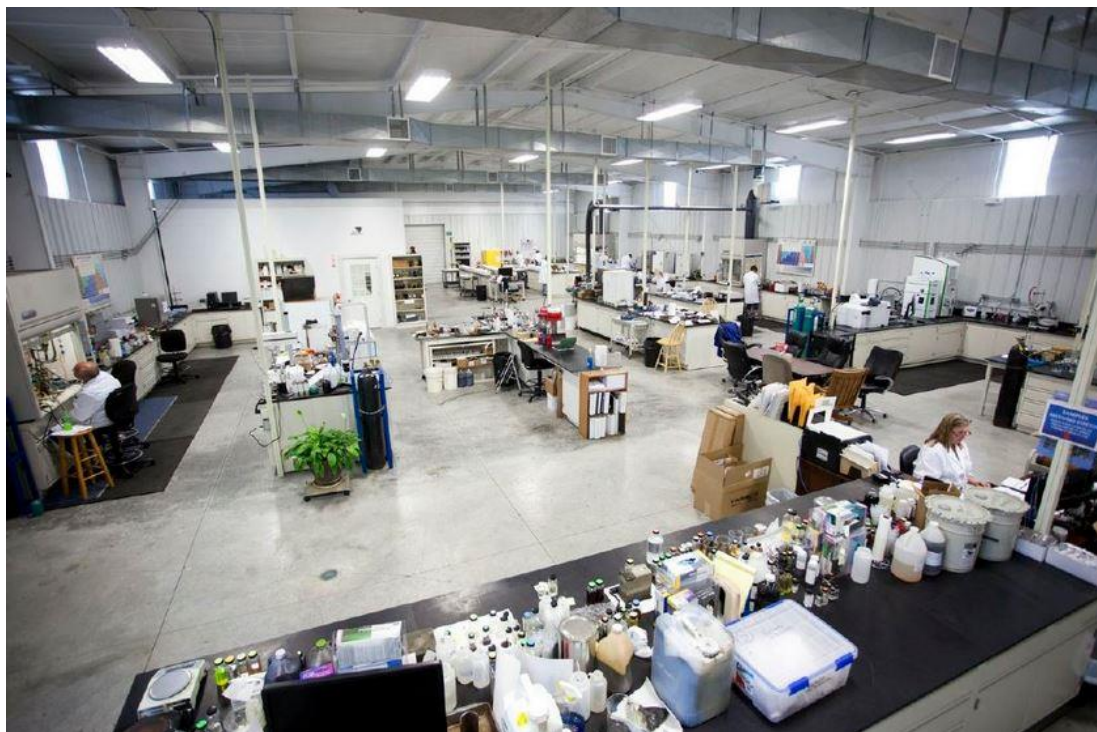
Now let's run through the day.

HOW THE DAY WENT..the *Nanotechnology* is in This Part

We all jumped on the tour bus at 7 am, coffee in hand, and watched the sun slowly rise over the horizon as we drove north to Sterling. We went from interstate to regular highway to sideroad to Sterling. Of course, everybody asks—why Sterling? And the reason is simple: love. Gene Zaid's wife is from there. When you find The One...you stay, wherever they are.

And Gene half-jokes that he only could have birthed JACAM in a town like Sterling. Back in 1982 when he started in his garage, the town shut down at 7 pm; if you even wanted milk after that you could be in trouble. The one stop light in town just goes to constant blinking after 6 pm. There wasn't a lot of temptations. So he just started working chemistry in his lab in his garage. (Fortunately for all concerned, the TV Show Breaking Bad hadn't aired yet ;-))

He first walked us through his diagnostic lab, which was like walking into NASA. Everyone was in white lab coats, and there was machine after machine lined up to do different tests on both old samples that customers brought in to illustrate a problem, and the new JACAM products that solved those problems.



We then moved over to the blending plant, which also houses the high and low temperature reactors. At the time, they were blending their oil-soluble hydrogen

sulfide scavenger. This is a UNIQUE product; that's an overused word now but nobody else in the world has this, they say. Not only is H₂S deadly poisonous, the rail car explosions have shown it's deadly flammable and explosive. This product can neutralize up to 14% H₂S in a storage tank (battery) in just one cycle. And with the Lac Megantic tragedy, oil companies are super-sensitive in making sure their oil has low to no H₂S.



That product was only developed two years ago, and it is already one of the Top 3 products they sell out of 400+ products. This is a company with \$700 million in revenue. Top 3 in two years.

The third building is brand new and is a testament to how quickly they move. This is where they will vertically integrate, and make amines through a process called "hydrogenation". This will all be done in 2015.



They have limited capacity right now, and are ramping up. One problem is that they only have so many welders, and they are also building a fleet of custom tanker trucks that deliver their liquid chemical products. The welders work on both, balancing current demand for their products (trucks) vs. being prepared for future growth (more reactors).

CEO Tom Simon was emphatic before we entered the fourth edifice: NO PICTURES. This building housed their solid chemical product area. I found this hard to believe but they have a patent on some solid chemical products; nobody else can make solid chemicals to compete against them. I should ask more about that because that doesn't sound like something you could patent—but what do I know?

But it's true they say—nobody else in the industry uses solid chemical products. These products come in waxy looking balls or pellets, and have slow-release features that make them useful for days or even weeks (e.g. to keep

pipelines free of bacteria).

I found it strange in retrospect that there should be no pictures allowed here because it was by far the lowest tech activity we saw in the JACAM complex.

The final building we saw housed the new mixing facility for the amine organo clay for the drilling fluid. There are only two suppliers of this product in the US, and it is required for all oil based drilling fluid systems. CEU now makes it

Then it was time for lunch—and I hadn't had any solid chemistry in me at all that day so I was hypoglycemic by then. The tour bus drove us one mile into the centre of Sterling where JACAM has its administrative building, right there on the main drag. Management served us a Texas brisket lunch complete with beans and sauce and potato chips—but no gingham tablecloth.

We were in a large conference room and Tom and Gene each said a few words and then they opened the floor to questions. (The sponsoring analyst hogged most of the question time, but being as he paid for my supper and my wine the night before, I decided that was a fair trade.)

NANOTECHNOLOGY POTENTIAL

As we ambled back to the bus in bright Kansas sunshine to head into town for lunch, I asked Butch—who was the CEO of one of the original acquisitions JACAM made 15 years ago—what was the latest technology JACAM had that he was excited about. I thought he was the right guy to ask because he had been with Gene for a long time. He was around when SuperCor was actually developed a full 11 years ago. Even the oil soluble H₂S is over two years old now. I wanted to know—what's the latest and greatest coming out of the lab *right now*?

He didn't miss a beat. "Nanotechnology." He replied.

I knew that meant small *something*, but I asked him to try to make it simple for

me. Basically it means using a lot smaller molecules to do the work you want done. And the application they have for it is in a new fracking fluid they have just finished developing. They've only been marketing it for four months.

The basic idea is that smaller molecules can get farther up the fractures in the fracking, and liberate more oil and gas—increasing reserves. Remember, the industry does like high flow rates but really it's the overall amount of oil or gas that gets produced that's important (I liken it to golf—driving for show but putting for dough).

That intrigued me—a lot. We had 20 minutes after the general Q&A to go ask any of the JACAM/CEU team some individual questions, so I bee-lined for the tall young man in charge of this new fracking fluid.

I asked him if there were any concrete, tangible numbers he could point to that showed their nanotechnology worked better than other products on the market. Well, I wish had my sunglasses because this guy lit up like a thousand watt light bulb. He couldn't wait to tell me..and I gotta say, I was impressed.

JACAM was able to convince one of the largest independent producers in the USA to do a 12 well test of this new fracking fluid. Drill 12 wells all in the same formation of the same play; six with JACAM's product (called a flow-enhancer) and six without. Every JACAM well came in better than those without, with 18-33% increase in flows over the initial 30 day production period (IP30).

Because most of the decline curves on tight oil production are the same, you can generally equate higher flow here with higher EURs—Estimated Ultimate Recoveries. It's a high enough probability that they shouldn't have much problem finding buyers for the product—especially as it's being sold at the same price as normal competitive frack fluids.

CONCLUSIONS

I left the day very convinced that even in an energy price downturn, CEU will continue to grow. As a shareholder, my biggest concern (because I always have to have one) with share price is multiple contraction across the sector if oil goes lower. I have NO concern with business prospects; as fast as they can hire competent people, there is business waiting. CEO Tom Simon and his team are committed to growing very responsibly and more slowly if necessary to preserve reputation and quality in the field.

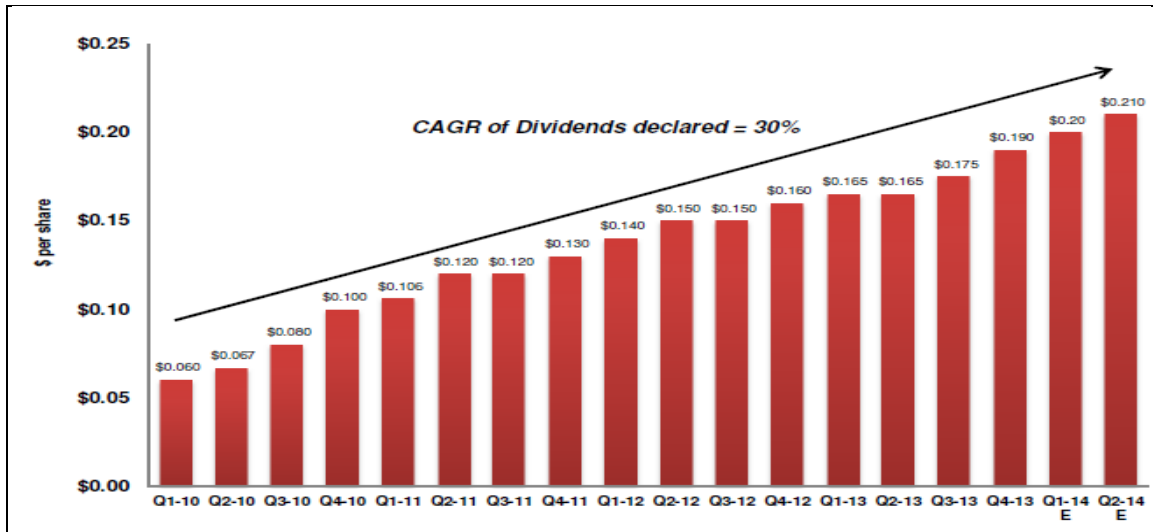
They have some things nobody else has:

1. SuperCor
2. Oil-soluble H₂S
3. Solid chemistry
4. Gene Zaid
5. Nanotechnology in fracking fluids
6. Vertically integrated chemical fabrication

AND NOW FOR THE FULL COMPANY WRITE UP...

OGIB BULLETIN # 19—UPDATED MAY 19 2014
CANADIAN ENERGY SERVICES
(CEU-TSX; CEDSF-PINK)

Since I first bought Canadian Energy Services in April 2010—they have split the stock 3:1—and are about to do so again! That's a total of 9:1! And, they have increased their dividend on ten separate occasions since I purchased it. The cash amount of the dividend I'm receiving nearly quadrupled since my original purchase. The chart below is truly the best one in the entire North American Energy Industry:



I still think this one has many more dividend increases and a lot of capital appreciation in front of it. How can they increase dividends like this? Through innovation, and a business model that has a low cost of capital vs. the heavy iron energy service companies like drillers and frackers.

On the innovation front, their new production chemicals business is growing a lot, especially in the US, while their drilling mud business will continue to grow market share in the US.

CEU's story has been supplying high-tech drilling fluids, or mud, to oil and gas producers, which helps keep the drill hole clean and managing well pressures.

But drilling only lasts 8-30 days per well. It produces oil or gas for years, though—sometimes decades. So it makes sense that CEU—which has a great track record of making their acquisitions show organic growth—would get into this more long term business.

There are several mega-trends CEU benefits from. One is simply—more wells. The IEA projects that North American oil supply will grow by 3.9 million barrels per day (mb/d) from 2012 to 2018. That will take a lot of wells.

These wells are getting deeper, longer, and more chemically complex. The new horizontal wells are longer—more metres—and need more chemicals per metre. The fluid/chemical business is up 4x in the last 10 years.

This new production chemicals business is being driven by a fairly new acquisition, which wasn't cheap but came with lots of spare capacity which is how they have been able to grow the business with almost no capex.

That means big increases in cash flow are coming, which means further dividend increases.

QUICK FACTS

Trading Symbols:	CEU-TSX; CESDF-PINK	
Share Price:	\$32.70	
2014 1 st Quarter Revenue:	\$231 million	big <u>overall</u> revenue jump
2013 1 st Quarter Revenue:	\$149 million	
2014 1 st Quarter EBITAC :	\$0.65 Per Share	big <u>per share</u> cash flow jump
2013 1 st Quarter EBITAC:	\$0.40 Per Share	
Shares Issued:	67.3 million	
Market Cap:	\$2.20 billion	
Net Debt:	\$355.0 million	
Enterprise Value (EV)	\$2.55 billion	
Dividend	\$0.90, paid monthly at \$0.075 (2.75% yield)	

<http://www.canadianenergyservices.com/>

POSITIVES

- patented products
- low cost of capital vs. frackers/drillers
- serial acquirers; very disciplined
- proven ability to increase US and Canadian market share--organically
- mgmt and directors own 18% of the stock
- spare JACAM capacity could create high margin growth
- trend toward long horizontal wells with more fracture stages

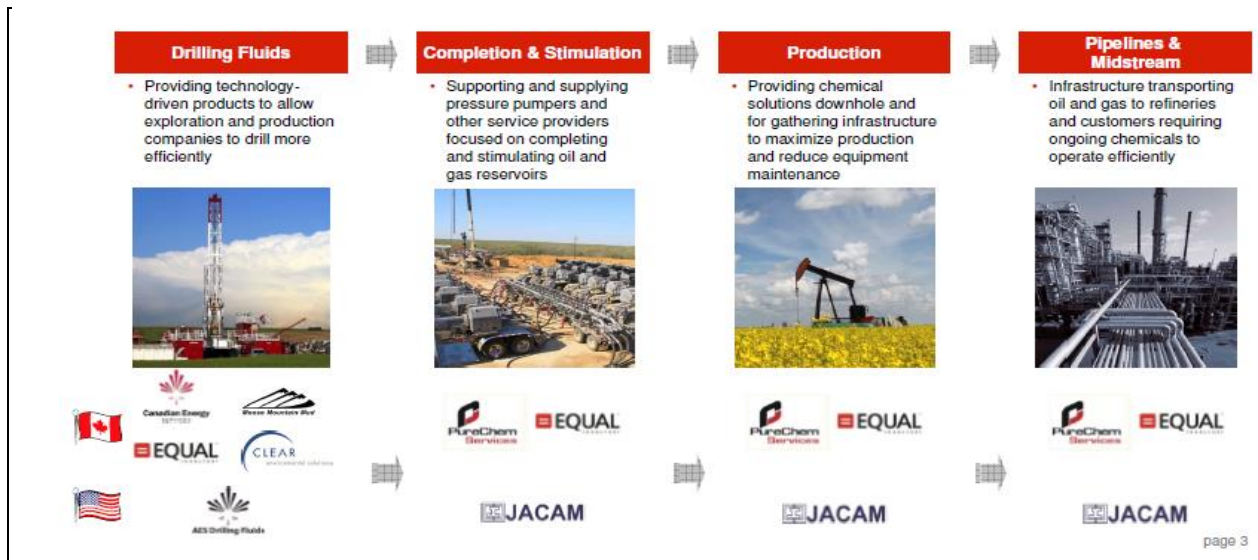
NEGATIVES

- small float makes for illiquid stock (but the 3:1 split should change that!)
- commodity price risk, lower oil and gas prices means less drilling
- environmental movement slows fracking revolution

THE BUSINESS

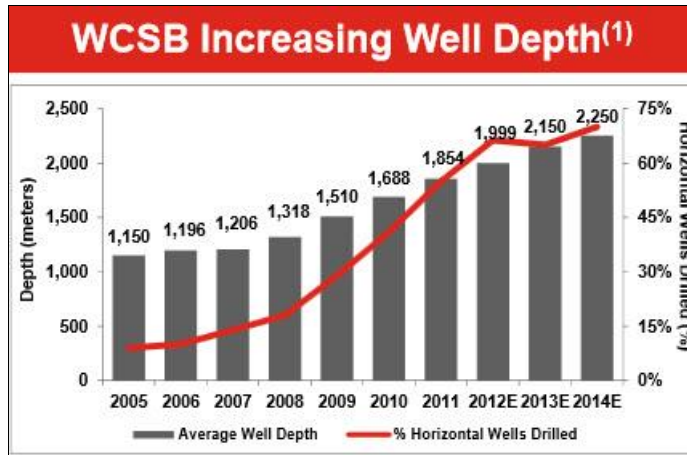
Canadian Energy Services (CEU) is run by founder/CEO Tom Simons and CFO Craig Nieboer. Collectively management and the Board of Directors own 18% of the company. The men in charge have their interests fully aligned with shareholders. I LOVE that....

CEU's goal is to sell chemical and fluid solutions through the FULL oilfield life cycle. That means CEU is there with the customer from the drill bit, to the completion of the well, to the fitting of the wellhead and pump jack and on to the pipeline and midstream market.



CEU operates two core businesses; its drilling fluids division and its production and specialty chemicals division.

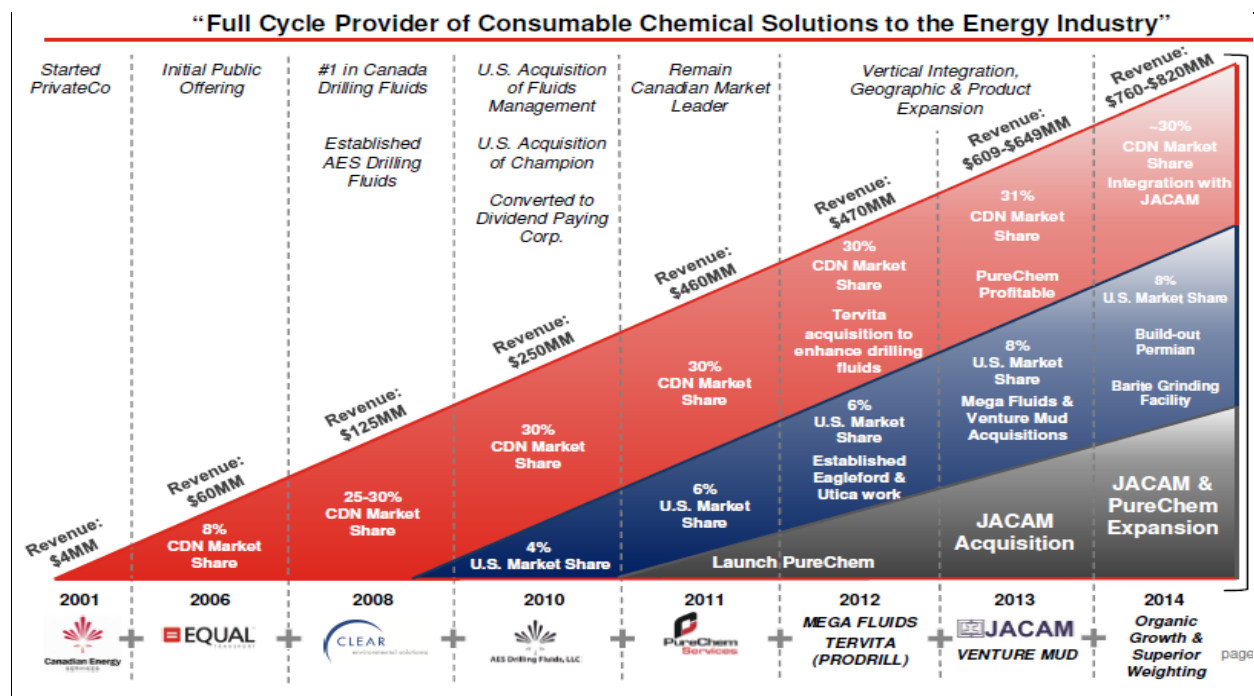
The trends within the horizontal drilling industry are also good for CEU. Horizontal wells keep getting longer and the number of “fracs” per well are increasing.



Longer wells and more “fracks” mean that more fluid is being used. That means more fluid is being sold by CEU. This is a business that should have the wind at its back for the foreseeable future.

COMPANY HISTORY

CEU has grown aggressively through acquisition. This slide from their powerpoint gives a picture of the businesses they’ve bought each year:



On March 1, 2013 CEU announced what is by far its most significant acquisition.

CEU acquired for \$240 million a private company called JACAM (pronounced JAY-kem) that makes/blends and sells oilfield-related specialty chemicals. The acquisition makes CEU considerably larger and adds a second major business line.

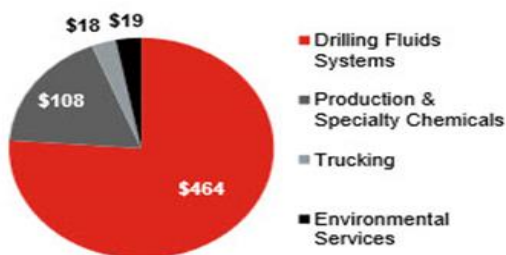
Not wasting any time CEU then also acquired the drilling fluids business assets from Venture Mud One L.P. for \$55.2 million. This acquisition joined CEU's drilling fluids business unit and provides the company with a platform for growth in the booming Permian Basin.

All of these acquisitions (particularly JACAM) make CEU a different company (in a good way) than the one that I first bought shares in way back in April 2010.

CORE BUSINESS UNIT #1 – DRILLING FLUIDS

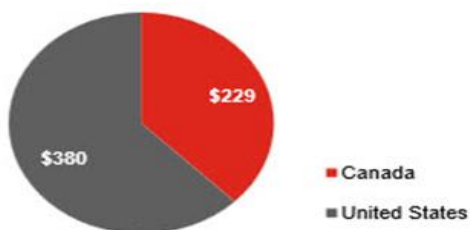
The drilling fluids business unit was the main focus of CEU prior to the JACAM acquisition and the reason that I first bought shares.

Adjusted 2012 Revenue by Division⁽¹⁾



In 2012 this unit generated \$464 million of revenue and will still be by far the largest unit for CEU in 2013 and 2014.

Adjusted 2012 Revenue by Geography⁽¹⁾



At the end of 2012 the company started disclosing financial performance information by U.S. and Canada rather than operating division (so we can't break these numbers down post 2012).

Every horizontal oil and gas well requires drilling fluids. Those drilling fluids include water and hydrocarbons

Total Revenue: \$609 MM

(1) After giving effect to Mega Fluids, ProDrill, and JACAM acquisitions

that are mixed with other things to create the desired formula.

Each specific mix depends on each particular company (the oil producer) and the particular resource play being drilled.

Every producer has their own “secret sauce” and different resource plays respond better to different mixes.

The purpose of the drilling fluid is to:

- Control formation pressure
- Circulate out drill cuttings
- Maintain a clean wellbore
- Prevent a well-bore collapse

The better the drilling fluid the faster a well can be drilled and the better the flow rate of the well. Drilling a well faster reduces the number of man and equipment hours per well. That brings down costs.

Improving the flow rate (both the initial production and the total oil recovered) increase the amount of cash each well generates. That clearly improves the profits for each well.

How the process works is that the fluids are pumped down the inside of the drill pipe, or drill string, and flow out around the face of the drill bit at the bottom of the hole.

This lubricates and cools the bit. The fluid also absorbs all the “cuttings”, the rock/sand/soil that has just been chewed up. The fluid then carries all that gunk back up the outside of the drill pipe.

That fluid system will be designed clean the hole, stabilize the rock drilled, control subsurface pressures, enhance drilling rates, and protect potential production zones while conserving the environment in the surrounding surface and subsurface.

The drilling fluids are a significant portion of the cost of a well, between 5% and 10%. Before selling the drilling fluid system to a customer, CEU works with the operator to design the perfect drilling fluid system.

CEU has an extensive product line of patented drilling fluid solutions for all of the onshore and shallow water offshore oil and natural gas wells currently being drilled in North America. A full list of the CEU drilling fluid products can be found here:

http://www.canadianenergyserviCEU.com/operations_drilling_systems.html

The main CEU product is called **Seal-AX**. This product is basically a patent for putting wax into the drilling fluid.

The wax goes down the hole as a solid, and as it hits the bottom, it gets squeezed out the bit like toothpaste coming out of the tube. It gets pushed to the outside of the well bore, coating it.

This has several benefits for the producer.

The wax makes the well bore more slippery and allows the drill to move through rock faster. This is especially important on the horizontal legs of wells. Vertical wells have the weight of the drill string to help push the bit down. You don't have that on the horizontal legs, so being able to "grease the wheels" with wax helps move the bit along.

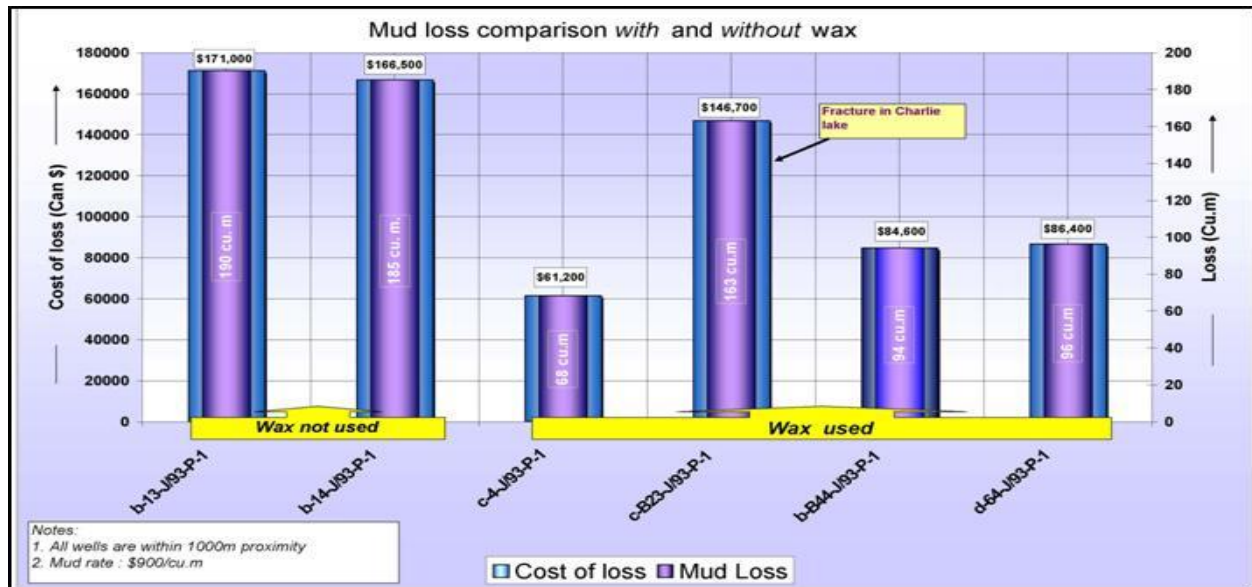
This increased lubricity (slipperiness) has an environmental and bottom line benefit, as oil based fluids are more slippery than water. With the wax, water can replace the more expensive oil in more applications, and the amount of chemicals is reduced.

The wax also helps the producer save money a couple other ways.

The coating helps keep in place the rock/sand at the edge of the well bore; i.e. it helps wellbore stability. One very large benefit of this is that in horizontal wells, the producer can get away with NOT cementing the bottom vertical part of the hole, right above the elbow before the well turns horizontal. This is called "monobore drilling".

The wax coating also prevents the expensive drill fluids from being absorbed into the surrounding rock, saving costs. This also prevents sloughing, as the fluids turn the dirt around the well bore into mud and cause the sidewalls of the wellbore to collapse.

The patents on **Seal-AX** run through March 2027 in both Canada and the United States.



CORE BUSINESS UNIT #2 – PRODUCTION AND SPECIALTY CHEMICALS

The second core business for CEU is the production and specialty chemicals division (PureChem and JACAM)—which got a lot bigger with the March 2013 acquisition of JACAM.

When the acquisition was made CEU expected this unit to be their growth engine over the next couple years and that has born out.

The big difference between the production/specialty chemicals unit and the drilling fluids unit is when each product is used.

The drilling fluids product is used only during the drilling process which takes 5 to 30 days. The specialty chemicals products are used over the entire life of a well—

which can be decades. This obviously creates a more reliable cash flow stream, and has given CEU a bump up in valuation to 12-14x cash flow.

If oil prices crash temporarily and drilling slows down a lot in North America the fluids division would suffer badly. No drilling means no revenue for the fluids division.

But already producing wells would keep on producing. That means that even if drilling slows down, CEU can still generate cash flow through the production and specialty chemicals division.

Just think about how many wells are being drilled every day in North America today. Once drilled and producing each of these wells need to be serviced regularly for decades to come.

And it is even better than that. More wells means more servicing. What also means more servicing is an increased amount of water that gets produced with each barrel of oil. As wells age, the amount of oil production declines, but the amount of water production increases which requires more chemical intervention.

For CEU that means that there will be continued growth in demand for its products simply because of the again of wells currently on production.

In 2011, CEU had started up their own chemical production business—PureChem—but it is not nearly as big as JACAM, and wasn't built to be the innovative, creative force that JACAM is.

Diversifying cash flow streams was a key driver behind the JACAM acquisition. JACAM was particularly attractive as it has lots of spare capacity—their operations currently are only 20% utilized.

That meant CEU could increase revenue without little or no capital—everything is built. It also allowed for management efficiencies, integrating JACAM into CEU, and cross-selling as JACAM brings with it an experienced management team, 300 customers and over 400 proprietary products.

I know this is a long report, but I want to tell you two very concrete stories that management relayed to me that show how they create compelling value for clients with the new Jacam line

Story #1

They just designed a new drilling fluid system for a big Montney producer. As background, almost all horizontal wells are drilled with an oil-based or “invert” mud system. Oil doesn’t get absorbed by the formation near the well bore so the industry thinks it’s better than water.

More background: Barite is a mineral that weighs up the mud. It’s very fine in the mix, but it remains as a solid or small particle.

Even more background: The Montney formation on the BC/Alberta border is THE big feedstock for LNG. It is hard thick rock, and you have to drill slow. Now, barite is a problem here. It interferes with the drill bit’s ability to get at new rock; it wears out the bit fast.

CEU replaced the invert system with highly saturated salt and water system—salt weights up the water like barite, and the salt is in solution (ie salt dissolves in the water)—and it doesn’t go out into the formation.

Nieboer said this doubled the pace of penetration. Further tweaks made it a triple. But corrosion was a big factor—oil and gas are corrosive and wear down expensive equipment really fast. They tried an off-the-shelf corrosion inhibitor, but it didn’t really work.

CEU had given this idea for JACAM to work on even before the acquisition closed. After three 3 iterations/trials, they solved the problem—with a custom corrosion solution made in JACAM’s Kansas facility exclusively for CEU. Double to triple the

penetration rate, better for the environment, and less corrosion on your equipment. Win-win-win.

Story #2

Oil-based drilling systems are more slippery. Water is less slippery. The industry lingo for slippery is “lubricity”. (Say that perfectly after a few sips of wine!)

You want your fluids to be slippery to help drilling go fast. JACAM set out to make their water solution more slippery. In January 2013 CEU convinced NuVista (NVA-CEU TSX; NUVSF-PINK—they were NOT a client at the time) to use their new drilling fluid solution in the Montney, which is a MASSIVE wet gas play along the Alberta/BC border in western Canada.

Nieboer says NuVista got improved results ASAP and went to all 3 of their rigs into the Montney. In their powerpoint they say they’re saving \$1 M a well—it’s this system. They also say they’re saving on mud and that’s true but it’s the increased rate of penetration and resulting reduced drilling time that saved them money.

ANCILLARY BUSINESS LINES

CEU has two additional business units—each of which generate about \$20 million or 3% of company revenue. Neither of them is expected to become a significant part of the company’s income, but they are high margin, complimentary businesses.

Environmental Division: Clear Environmental Solutions, provides environmental and drilling fluids waste disposal services primarily to oil and gas producers active in Western Canada. The Environmental business involves disposing of or recycling fluids produced by drilling operations.

Transportation Division: CEU has a trucking business, which carries their products and others to job sites. The main reason CEU is in this line of work is to guarantee delivery of their own products to their jobs.

FINANCIALS

The JACAM acquisition not only changed the operations of CEU, it also significantly changed the company's balance sheet.

From 2008 through the end of 2012 CEU always maintained more working capital than debt. That means that the company had more liquid assets than debt.

With the \$240 million JACAM acquisition—which was completed using 25% stock and 75% debt—CEU found itself with debt that was \$170 million more than its net working capital. At the end of March 2014 the amount of debt exceeded net working capital by only \$100 million. So CEU is getting its balance sheet back in shape fairly quickly.

Subscribers should remember two key points on this large increase in debt:

1. JACAM cash flow is much more predictable than the fluids business. A more reliable cash flow stream allows for more debt to be used.
2. Management feels confident JACAM cash flow will grow significantly over the next two years. Cash flow growth deleverages the company without any actual debt reduction.

JACAM is only operating at 20% of its capacity. Simons and Nieboer have been very successful in growing their acquisitions organically, and quickly, after bringing them into the fold—six since 2008.

CEU further manages the risk from the new level of debt by keeping a very liquid balance sheet. At Mar 31, 2014 CEU had a positive net working capital position of \$240 million and \$35 million available on its credit facility.

If you always have some cash in your jeans and can pay your bills it is hard to get into too much trouble. Liquidity is always key.

The company now pays 90 cents a share in dividends, paid monthly at 7.5 cents each. On 67.3 million shares, that equals \$60 million in dividends. Funds flow from operations in the first quarter of 2014 was \$36 million which would suggest an annualized rate of \$144 million. That would put CEU at a payout ratio of about 42%. *This is one of their lowest payout ratios ever, which is why I think they were willing to split the stock 3:1 again.* They usually up their dividend by half a penny a month.

Despite increasing the monthly dividend \$0.055 cents to \$0.075 cents over the past year, the payout ratio has actually dropped from 48% to 42%. The dividend has not only increased, but has actually become even more sustainable.

The less debt the better, but the amount CEU has taken on appears reasonable and will be carefully managed by keeping a lot of liquidity and continued growth in cash flow.

VALUATION

The fluid companies like CEU have a much lower cost of capital than the “Iron Men”the frackers and drillers. The reason for this is simple; the drilling fluids business is a better business.

The drilling fluids business has stable margins—25-30%--and requires very little capital. That means that any growth in revenue drops straight to the bottom line. That is why CEU has been able to increase its dividend so quickly that I’m receiving a 19% yield on the initial shares I purchased.

Meanwhile the heavy iron business of fracking and drilling requires a LOT of capital. If a drilling company wants to grow its business it has to spend millions on

new rigs and equipment. Having all that capital tied up in iron is a riskier way to try and turn a profit.

Further, CEU's specialty chemical business is not dependent on new wells being drilled, this business services producing wells. That also stabilizes margins throughout the business cycle.

So the market gives the fluid companies a higher multiple—8-10x cash flow vs. 4-6x cash flow for frackers and drillers.

CEU's main competitor in Canada, Secure Energy Systems (SES-TSX; SECYF-PINK) is currently trading at a 1.0% yield and about 15x cash flow.

CEU meanwhile trades at roughly 14x cash flow and has a dividend yield of 2.75%.

For 2014 management has guided for revenue of \$760-\$820 million and EBITDA (EBITA is basically cash flow before interest and taxes are paid) of \$135 million-\$150 million—that's a 30% jump over 2013.

The general consensus amongst the analyst reports that I have read is that this guidance is very conservative as it assumes no cost savings being found relating to the acquisition and limited growth. Given that first quarter revenue and EBITA were \$231 million and \$44 million respectively, I'd say 2014 guidance is in the (sand) bag.

Income before taxes	25,422	13,454	89%
<i>per share – basic</i>	0.38	0.23	65%
<i>per share - diluted</i>	0.36	0.22	64%
Net income	19,492	9,959	96%
<i>per share – basic</i>	0.29	0.17	71%
<i>per share - diluted</i>	0.28	0.16	75%
EBITDAC ⁽¹⁾	43,522	23,587	85%
<i>per share – basic</i>	0.65	0.40	63%
<i>per share - diluted</i>	0.62	0.39	59%
Funds Flow From Operations ⁽¹⁾	35,566	17,872	99%
<i>per share – basic</i>	0.53	0.30	77%
<i>per share - diluted</i>	0.51	0.29	76%

If you ever wonder how an expensive stock can make for a great investment, look no further than the image above. These columns compare first quarter 2014 with first quarter 2013.

On a per share basis (and remember that is what counts) CEU has grown cash flow by 77% year on year. If an investor paid 12 times 2013 cash flow last year to own this company, that purchase price has become only 6.7 times 2014 cash flow.

These kinds of rates of growth make a seemingly expensive price for a stock look very cheap in a hurry.

WHAT THE ANALYSTS SAY (pre split)

<u>FIRM</u>	<u>TARGET PRICE</u>
Alta Corp	\$45
Clarus	\$38
Cormark	\$39
Euro Pacific Capital	\$36
First Energy	\$39
National Bank Financial	\$37
Peters & Co.	\$40
RBC	\$34
Scotia	\$40

STOCK CHART



CONCLUSION

I'm a growth investor. The 90 cent a year dividend to me is only helpful when market conditions are weak, and the dividend helps support the stock.

Saying that, I'm now earning 9% on my initial shares of CEU. Growing dividends is the true measure of wealth. The growing dividend chart of CEU is testament to the low capital nature of the business, and management's ability to execute.

This management team has a great track record in generating big organic growth in their acquisitions. They're excited about JACAM and its production chemical business, and they see a long-term, stable contribution to EBITDA here.

I expect JACAM to be the growth engine of the company over the coming 18-24 months, but the truth is—they're growing EVERYWHERE—every basin in North America in which they are operating.

With the trend towards longer horizontal wells—and oil wells, which use more chemicals than gas wells—there is a big tailwind for Canadian Energy Services.

I think the proposed 3:1 stock split is management's way of saying they see a lot of growth in JACAM—remember, the plant was only at 20% capacity a year ago, and it's just over 30% now. So they can grow cash flow a lot right now with almost no capex increases—that makes for high margin growth.

I own 14,500 shares of Canadian Energy Services at prices ranging from \$4.78-\$12.95 (this is pre split 3:1).