OGIB BULLETIN #202 - October 19th, 2016

SELECT SANDS SNS-TSXV; CLICF-PINK

COMPANY ANALYSIS

Select Sands is a junior frac sand company about to go into production--just as pricing for frac sand looks like it is about to jump. Their grassroots asset--the Sandtown Sand deposit in NE Arkansas--has attracted the attention and money of a group of US investors, because of its high quality sand and its location (it is 650 miles closer to the Permian than the Wisconsin assets that supply most of the industry).

That US group has now funded Select Sands for US$12.5 million--enough to get the company to positive cash flow. CEO Rasool Mohammad has found the operating management team, bought wet and dry plants for pennies on the dollar, and has the attention of most of the major industry frac sand buyers.

It is a perfect case of a "speculation" that is now turning into a real operating company.

If the stars line up, I think Select Sands could make me 10x my money in 2-3 years. For that to happen however, they have to execute flawlessly:
1) They have to find customers in the energy sector; right now they have nothing except expressions of interest.
2) They must integrate the wet and dry mills around the asset to minimize costs.
3) They likely have to build a transloading facility.

But right now, the Market sees the price for fine mesh frac sand--which is what Sandtown has--going higher from the current $25/ton to potentially $60/t within the next 15 months. If that happens, profit margins soar to $40/t for SNS and $50 million in EBITDA is possible--on a 20x multiple that's a $1 billion market cap for a company with 100 million shares out.

I'll explain below why I think this path isn't that far-fetched however. Even if frack sand stays at $25/ton, the numbers support a share price very close to the current share price--that gives me a very asymmetric risk/reward. Heads I win dollars, tails I lose pennies.

QUICK FACTS

Share Price:	$0.92
Basic Shares Outstanding:	94.9 million
Market Cap:	$87.3 million
Net Cash:	$21.5 million
Enterprise Value (EV):	$65.8 million
Projected 2017 EBITDA:	US$15 (Cdn $20) million
Ent Val / 2017 EBITDA:	3.4 times
Projected 2018 EBITDA:	US$50 million (Cdn$65 million)
Ent Val / ’18 EBITDA:	1.0 times

NOTE—all numbers reflect the October 2016 financing and assume a total of 21.376 million shares issued with net proceeds of Cdn$15.5 million

http://www.selectsandscorp.com

POSITIVES

- Closer to Permian than most frac sand deposits—Location Location Location
- Now that the Permian creates 1 yr paybacks at $40 oil, the Market is confident frac sand will be in steady demand--increasing the multiple
- Debt free balance sheet
- Industry moving towards more sand per well and finer mesh sand
- Rising rig counts means more demand for sand
- Acquired plant assets for pennies on the dollar
- Latest financing funds company to positive cash flow

NEGATIVES

- This is still a development stage company with no positive cash flow
- Have yet to secure an energy sector customer
- Mgmt has yet to prove operational expertise
- EBITDA projections assume assets get developed & sales roll in…that may not happen on time

BACKGROUND/PROPERTIES

Select Sands just raised US$12.5 million to develop their high purity frac sand deposit in Arkansas. The company has been working on this deposit for two years. CEO Rasool Mohammad did this the old fashion way. He worked the phones, made some contacts, and went down there himself.

Mohammad, of Pakistani origin, drove around rural Arkansas developing his network and checking out properties. It was boots-on-the-ground research.

Now, Mohammad has put together the asset, the infrastructure, the operational management and the financing, turning this “deal” or “story” stock into a real company.

Before I get into Select Sands asset in detail, let me take a minute to review the frac sand business. It is a good one and it keeps getting better.

Over the past couple of years there has been a big shift in the frac sand market in the USA.

Low oil prices have forced changes to fracking design used in oil and gas well completion. Companies have been aggressively experimenting with their frac jobs in order to find the most profitable combination of lower costs and higher productivity.

Necessity is the mother of invention…….and $40 WTI prices has been the provided the reason to make big positive improvements to fracking in a short window of time.

From Q1 2014 to Q2 2016 the industry has moved towards using much higher quantities of finer grade sand (40/70 and 100 mesh) with a high crush strength—and away from the coarser sand that was popular previously. Select Sands sand has high crush strength.

The shift to finer mesh sand from coarser mesh sand in frac design is because finer mesh sand can reach further out in the fracture. The major frac sand companies started reporting this shift to finer mesh sand in Q1 2015.

Not only has the type of sand being used shifted, so too has the amount being used per frac job. Sand intensity has gone up from an average of 2000 tons per well in 2012 to over 4000 tons per well in 2016.

That is on average. Companies keep pushing the envelope.

There are wells in Louisiana where there has been up to 25,000 tons per well being used. These new enhanced completions or high intensity methods use mostly finer grade sand (40/70 and 100 mesh).

Just think that:
a) wells are being drilled more tightly; now 16 wells per square mile is not unusual vs. 4 a few years ago
b) horizontal leg length still increasing (7100 ft in H1 16 vs. 6850 in 2015)
c) amount of sand used per horizontal foot is going up HUGELY--35%-40% over last year

Here is a sample of what analysts are calling for in terms of frac sand demand going forward:

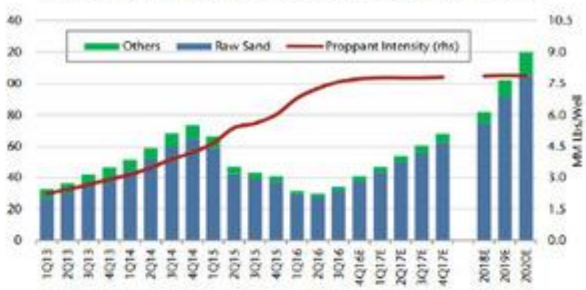
+ "Coupled with higher sand/well, we thus see sand demand rising ~70%/80% in 2017/18" – May 2016,**Morgan Stanley**
+ Pickering estimates …the sand consumption can grow from about 30MM ton this year—a four- or five-year low—to 70MM ton-100MM tons by 2018 – June 2016,**Citi and Tudor**
+ Frack sand demand estimated to grow from about 30 MM tons 2016 consumption rate currently, to 50 MM tons in 2017 and 64MM tons in 2018 – June 2016, **Goldman Sachs**
+ "Sand will be the fastest growing sub-segment of the oilfield services market" – Sept. 2016, **Credit Suisse**
+ From Q1 2014 to Q2 2016 well completion is using substantially higher quantities of finer grade sand (40/70 and 100 mesh) which has increased from 40% to about 60% - Mar. 2016 **NavPort**
+ Based upon recent industry reports, leading US based fracking companies are now using up to 2,500 pounds of frac sand per lateral foot per well, with some wells requiring 25,000 tons of sand for one well completion; two years ago the average well would use approximately use 800 lbs. of frac sand per lateral foot

Here are some very recent comments from US brokerage firm Jefferies:

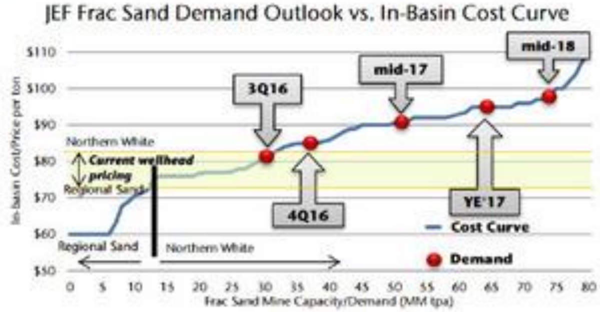
Summary Frac Sand/Proppant Outlook

- We believe Frac Sand demand troughed in 2Q16 at ~27-28MM tons *(annualized)*
  - This assumes average proppant intensity of ~7.3MM Lbs./well in 2Q16 (up ~35% y/y)
- Our Framework indicates Sand demand rising to ~50MM tpa by mid-17 and ~62MM tpa by YE'17
  - This means 4Q17 Demand is almost equal to 4Q14 Peak Demand with less than half as many rigs
  - This assumes ~86% increase in proppant/well between 4Q14 and 4Q17 (= only 3% increase from current level)
- We believe effective frac sand supply increases to 80/84/89MM tpa by YE'16/'17/'18
- Our Industry Cost Curve suggests structural pricing power can return by 2H17 (details on Page 26)
  - However grade/basin level tightness can allow for some pricing uptick coming through in early 2017

Frac Sand Demand and Intensity Trend, 1Q12-2020E



JEF Frac Sand Demand Outlook vs. In-Basin Cost Curve



Note: In-Basin assumes delivery to Midland, TX; Source: Jefferies estimates, Baker Hughes, NavPort, State Regulatory filings

Energy

Target | Estimate Change

October 18, 2016

We expect structural pricing power to come in 2H17 and accelerate in 2018

Our Industry Cost Curve V2.0 includes 106MM tpa gross supply and updated estimates

We believe pricing need not fall, but any structural step-up may not be imminent:

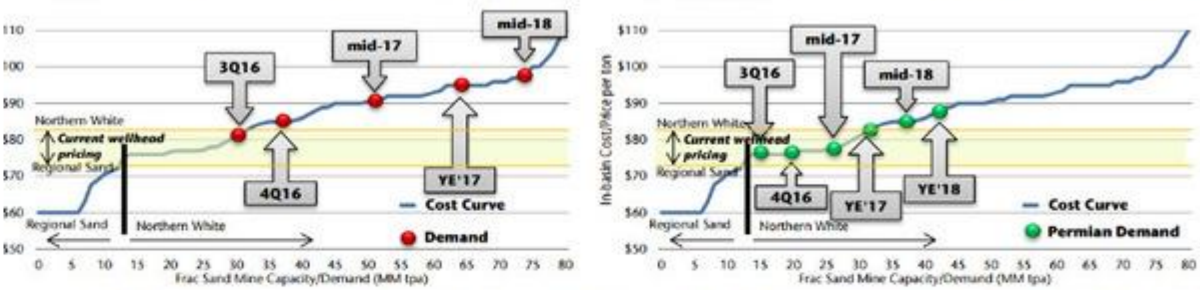
- Current wellhead pricing of ~$72-$82/ton (~$62-$72/ton at transload) is low enough to deter undercutting
- However, regional nature of frac sand (logistics) market indicates Permian demand alone cannot drive pricing
  - Several new regional and northern white sand mines now favorably deliver into the Permian (especially Midland sub-basin)
- BUT E&P demand for finer – 40/70 and 100 mesh – sand can yield pockets of pricing improvement early in 2017

We revise our structural pricing improvement expectation to 2H17 (from early 2018):

- Our more favorable outlook stems from stronger demand partially offset by continued lowering of the cost curve
- However, stranded logistics costs (e.g. idle rail cars) may continue to incentivize market share over pricing in 1H17

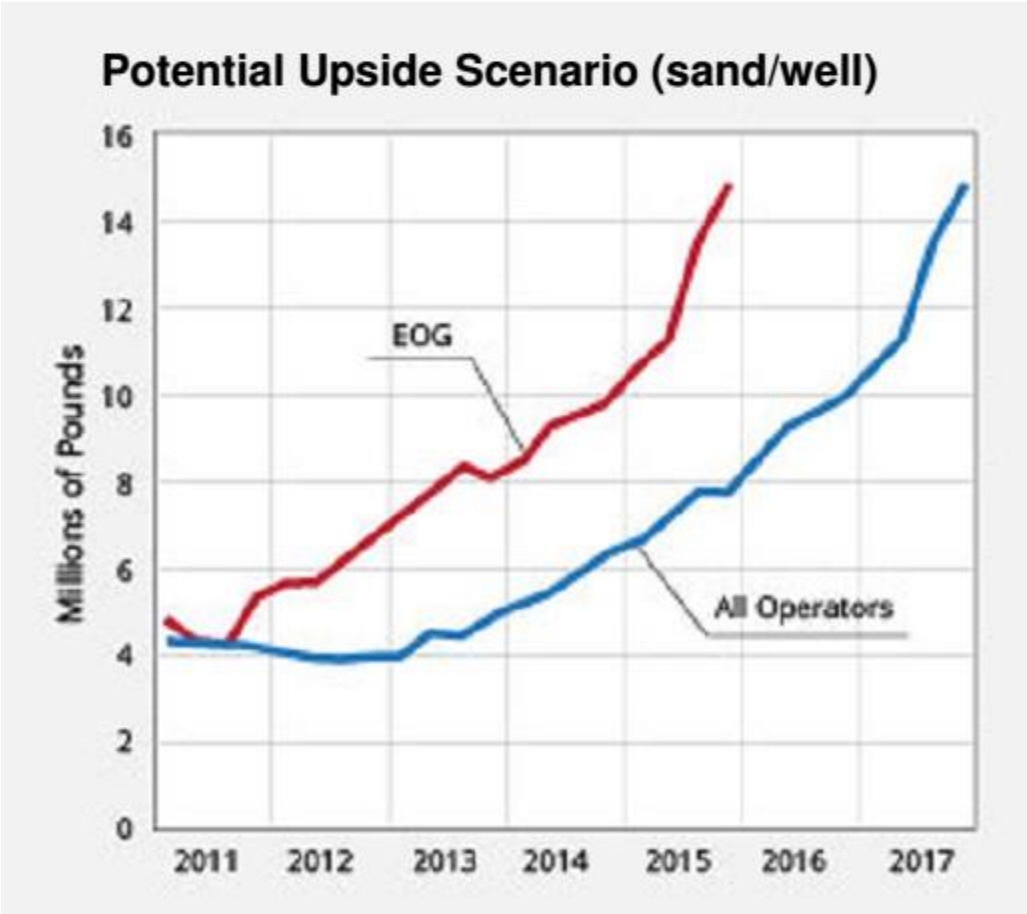
JEF Total Frac Sand Demand and In-basin* Cost Curve

JEF Permian Frac Sand Demand and In-basin* Cost Curve



Source: Jefferies estimates, Company data *In-basin Cost Curve assumes delivery at Midland Basin (includes last mile trucking from transload to wellhead)

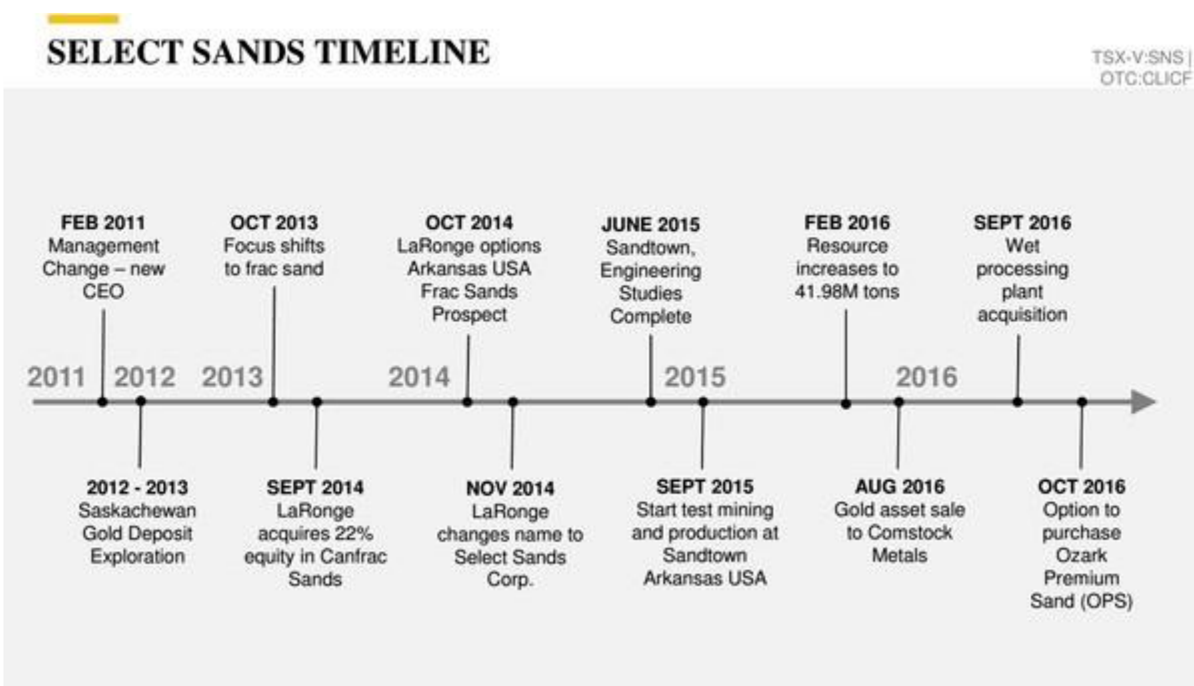
You can see from the graph below that EOG has long been using a lot more sand than competitors in its frac jobs.



EOG is generally thought to be the premier shale operator so it is quite possible that we will see the rest of the industry move in this direction.

With the increase in sand used per well, most analysts see demand for sand growing rapidly from a low point reached this summer.

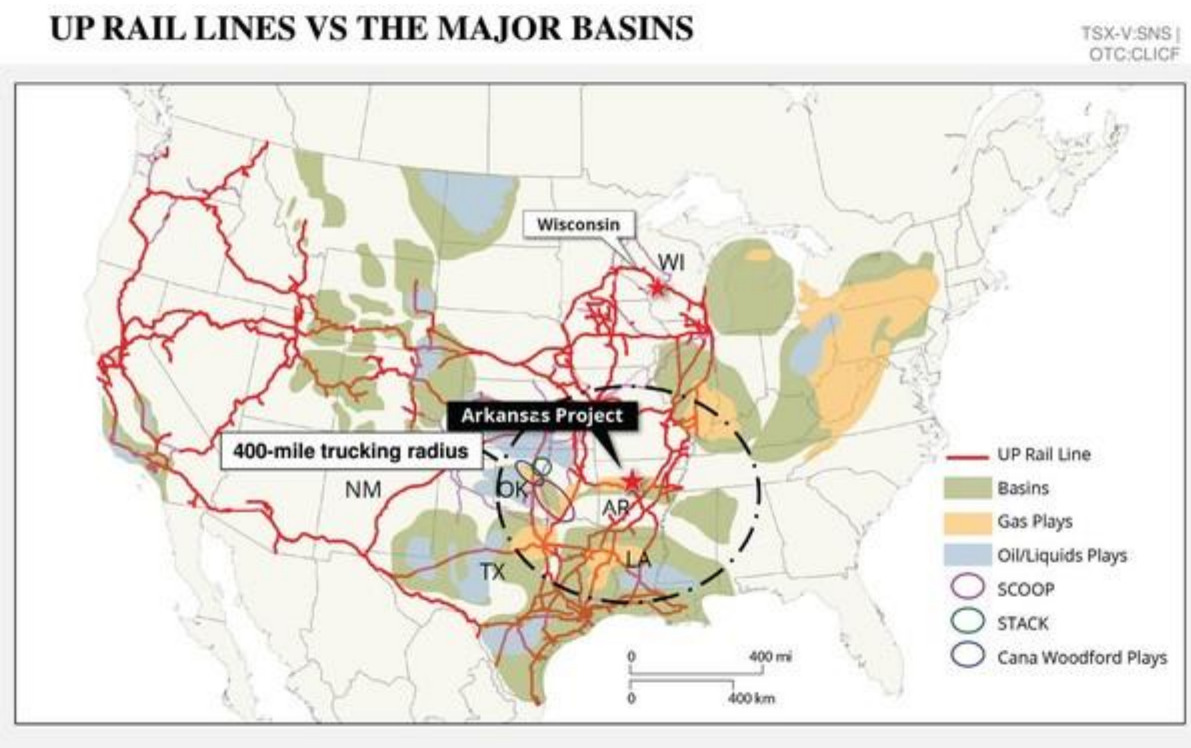
Select Sands Arkansas Asset



In the same way that **Lilis Energy (LLEX-OTCBB)** may be the last micro-cap in the Permian, Select Sands is only small cap way to play this sector that I can find.

No one covers this name – yet. But I do expect US coverage before year end—which means US stock multiples—which is around 15-20x EBITDA.

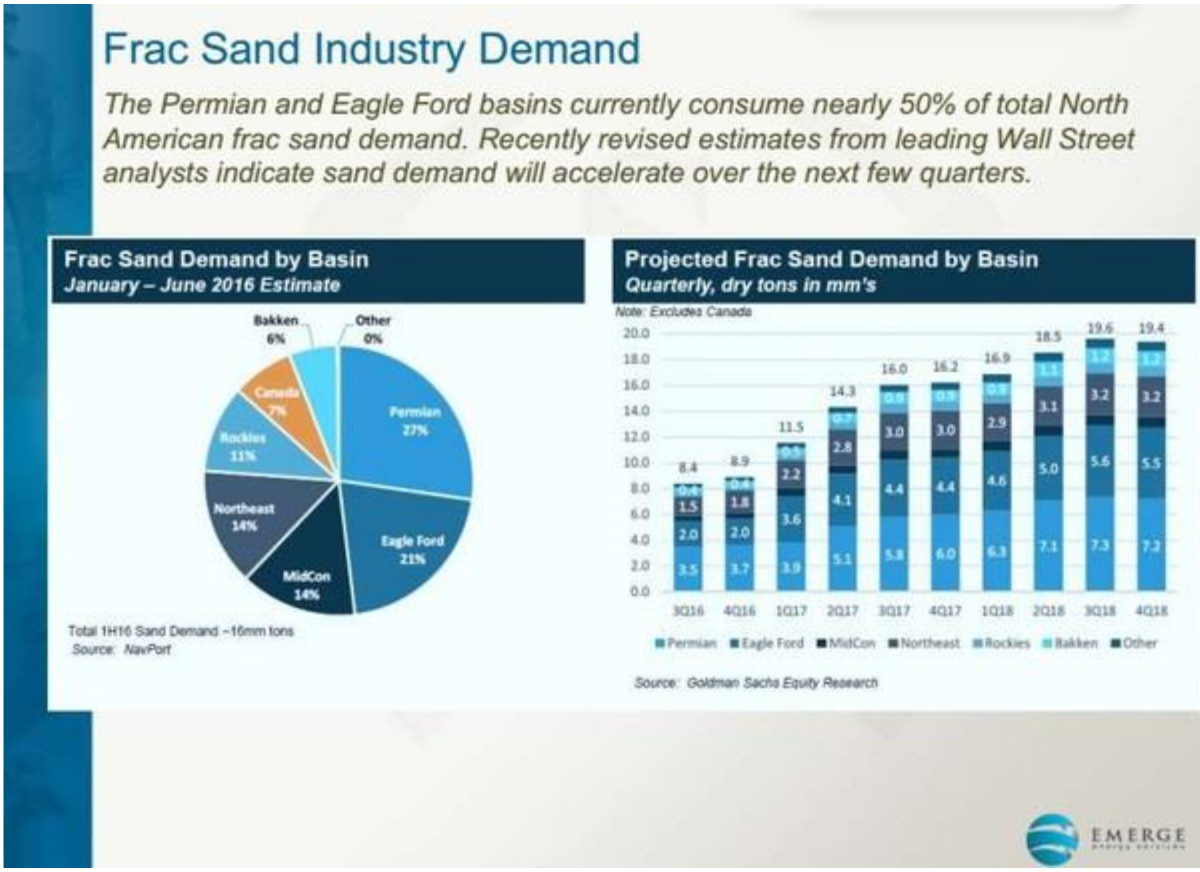
The sand deposit that Select has is unique in one very important way…..location.



The big frac sand deposits are located in the northern state of Wisconsin. Select's asset (called Sandtown) is located in Arkansas—which is a major advantage, resulting in lower transport costs. These logistical costs are usually more important than the cost of the sand in getting the cheapest price possible.

The most profitable shale oil plays are located in Texas and Oklahoma. The Permian and STACK/SCOOP are the two regions where a growing percentage of drilling rigs in operation have been directed.

The Permian and Eagle Ford (also Texas) alone accounted for 50% of American frac sand demand through the first half of this year.



Take a look at the earlier slide and look at how much closer Arkansas is to these active plays than Wisconsin is. Now think about just how much sand has to be moved. My point…….logistics are a HUGE part of the delivered cost of frac sand.

Most producers are using up to 2,500 pounds of frac sand per lateral foot. With that we are talking about up to 25,000 tons of sand for just one well completion. Two years ago companies were using a third of that.

I wonder where we will be two years from now?

Select's asset has an indicated resource of 42 million tons of silica sands. The type of sand is split as follows:

- 58% 100 mesh
- 22% 40/70 mesh
- 20% 20/40 mesh

The 100 and 40/70 mesh are considered finer mesh. That represents 80% of the Sandtown asset. The fact that the majority of this resource is finer mesh sand is important. New fracking techniques are causing demand for finer mesh to increase at a much faster rate than it is for coarse sand.

The Sandtown deposit also has premium “Northern White” fine mesh sand priced for its spherical qualities and high crush strength; up to 10,000 psi plus.

The company started selling sand on a test basis in the industrial market in the first quarter of this year. These aren’t energy sector customers, these are roofing and construction related businesses. The margins in the industrial markets are actually substantially higher than the oil and gas markets but the volume is lower.

To really move a significant amount of product Select needs energy sector customers. That’s a risk; they don’t have one yet.

Tapping into energy customers is the next step. The company expects that to happen early in 2017.

The timing of that couldn’t be much better. The industry is seeing both an increase in demand for finer mesh (preferred for new fracking techniques) while at the same time the availability of finer mesh in the Midwest is limited. Some analysts are calling for a shortage early into 2017.

Mohammad and his team have done great work—as you’ll read below—but they also got lucky. When they went to Arkansas and acquired the Sandtown asset finer mesh sand was not what the energy producers wanted. The industry was going in the other direction and there was a real chance that Select was chasing the wrong type of sand.

When SNS bought Sandtown, EOG had been experimenting with finer mesh, but there was no certainty that it would grow in popularity.

Without this recent move to finer mesh, this Sandtown asset might be of limited value.

I’ve been following the Select Sands story since its birth (go read the two corporate bulletins I wrote about them in 2015 on the website) and I didn’t own any shares myself for this very reason.

FRAC SAND GEOLOGY

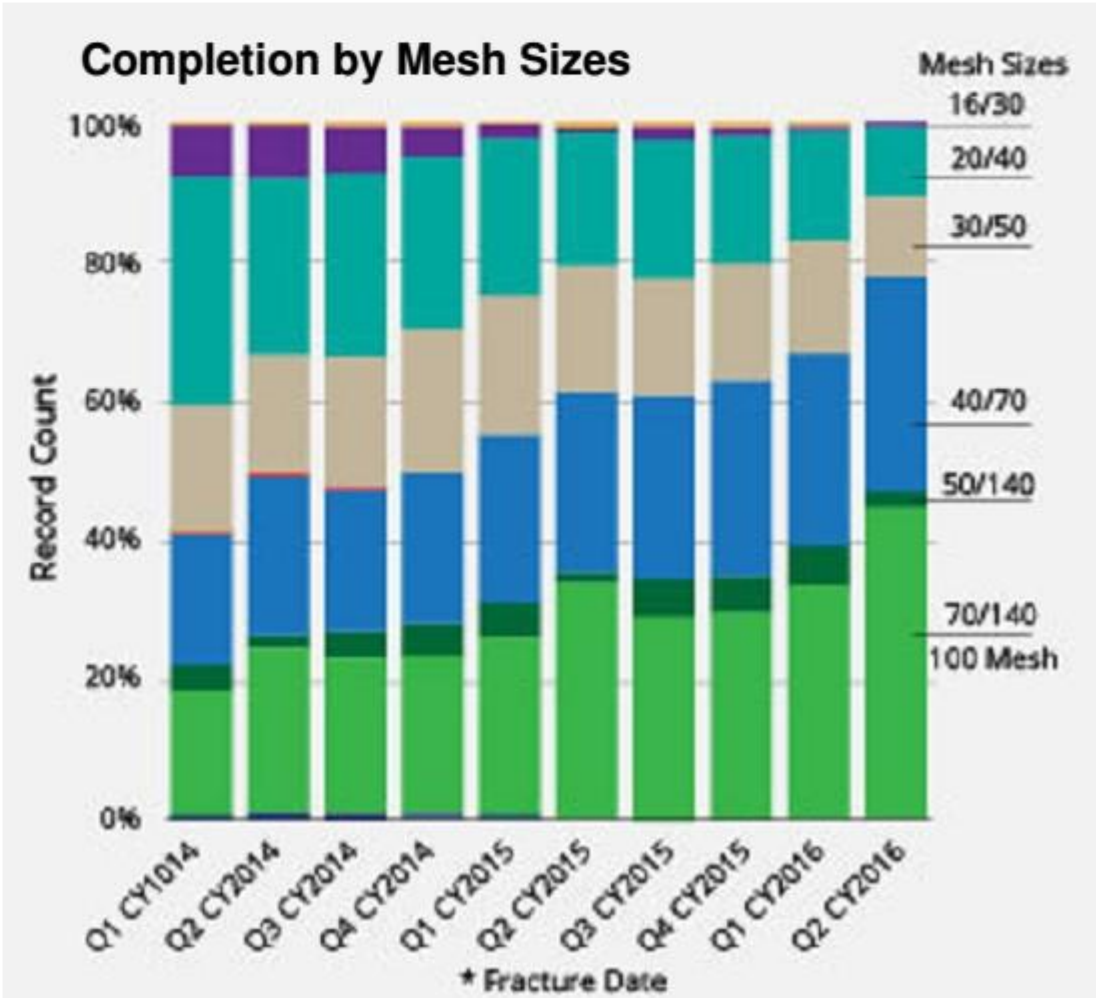
The geology of why the Midwest has coarser sand and further south has finer mesh is interesting. Back when much of North America was covered with ocean the Midwest would have been the beach. On the beach coarser mesh sand sat at the top and the finer mesh went to the bottom.

Further south in Missouri, Arkansas and Oklahoma was the deeper part of the ocean which is where most of the finer mesh sand went. I don't know why exactly…..you can "Google-it" and shoot me an e-mail.

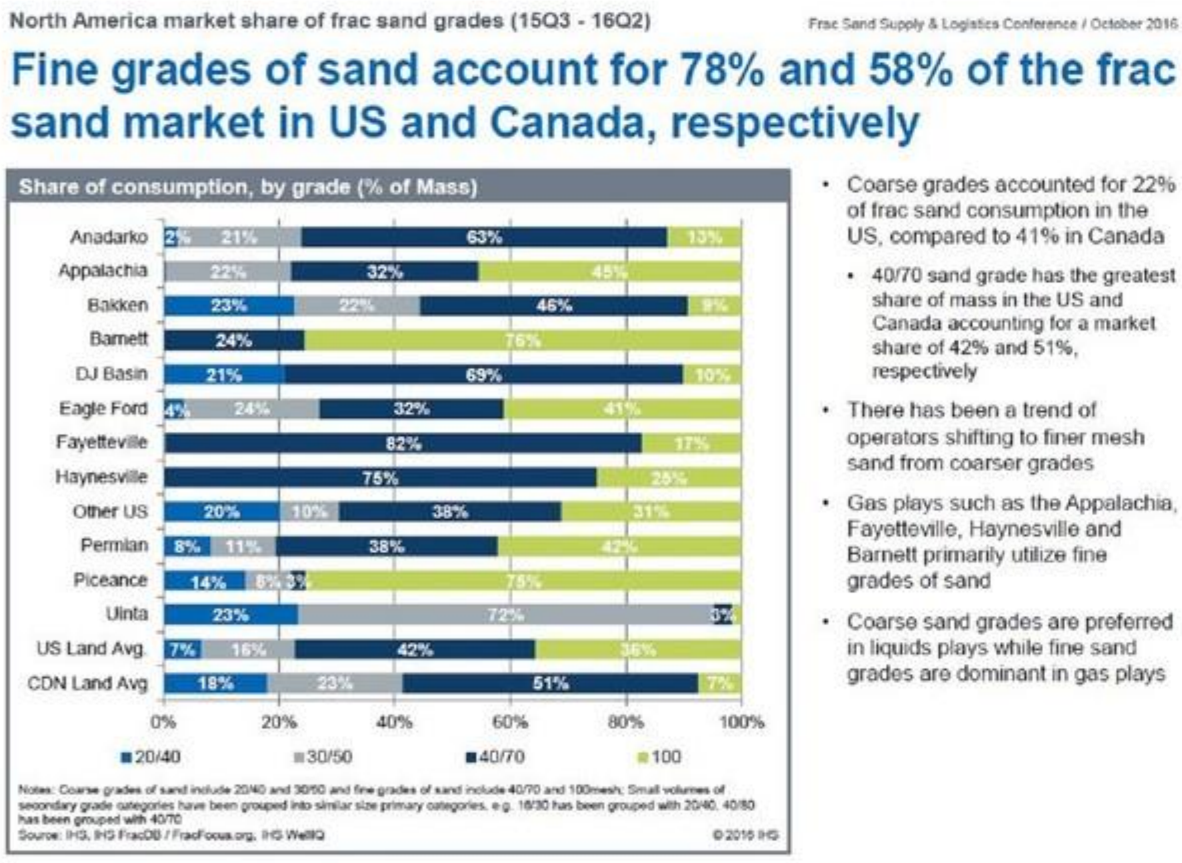
Way up north in Wisconsin (the beach)—where the major frac sand players are—the sand is typically one-third coarse, one-third medium and one-third finer mesh. Where Select is (bottom of the ocean) 80% of the sand is finer mesh.

The reason for the pivot by the energy industry to finer mesh sand is that the coarser sand is too dense. It gets stuck in the micro-fractures that the industry is doing—which reduces hydrocarbon flow.

Finer mesh (40/70 to 100 mesh) has grown from 40% of completions in Q1 2014 to over 80% for the quarter ended June 30, 2016.



Even more important for Select Sands is that finer mesh is dominant in the southern horizontal plays (Permian, Haynesville, Fayetteville) where it is closer to.



Having mostly finer mesh sand puts Select in a good position. As I mentioned before what puts the company in an even better position is its position…..literally.

They can operate year round, whereas Wisconsin does have some winter issues sometimes with frozen ground. Sandtown is 650 rail miles closer to Texas, Oklahoma and Louisiana than the Wisconsin silica mines. This should offer up to $15/ton in transportation savings cost.

The table below walks through the cost advantage that Select Sands has over an Illinois mine for delivery to the Permian. For Wisconsin, add at least another $5/ton.

Mid Cost NorthernWhite-Destination Permian (delivered Cost US$/Ton)			Select Sands Delivered Costs to Permian(Origin Arkansas)	
Mining	**15**	**Estimated production cost**	**20**	
Shipping	45.65	BN to BN unit train rate (Illinois origin)	33	
Storage	4		4	
Transloading	4		4	
Detention/Demmurage	-		-	
Trucking	20	*Transload ~100 miles from well site*	18	*Tutle & Tutle truck cost quote of 15c -ton/mile; 100 miles plus 50 miles from Quarry to the plant*
Total	**88.65**		**79**	

The estimate production cost for Select is about $5 per ton higher. The big advantage is on the shipping line where the 650 mile proximity advantage kicks in. Select also has a couple of dollars less per ton of trucking cost due to the trucking arrangement they have with Tuttle and Tuttle trucking (more on them in a minute).

Add it all together and Select has an all-in delivery cost of $79 per ton versus $88.65 per ton for a typical Illinois competitor.

Low cost wins in the commodity business...always.

The Three Game Changers—Operations Management, Recent Financing And Acquisition

I've been closely following Select Sands from virtually the beginning. CEO Rasool Mohammad who is an enthusiastic advocate for the company basically made it impossible for me not too.

My interest was lukewarm. I loved the proximity to the Permian from the get-go. I had no idea what kind of asset the company really had.

The industry moving towards finer mesh got me more interested….but it wasn't enough.

Then Rasool made an important management addition—Zig Vitols. Zig has done this before—moved millions of tonnes of materials, like aggregates (gravel) and heavy building stuff. Here is his bio from the website:

ZIGURDS R. VITOLS

COO & Director

Mr. Vitols has served as the President, Mid-South Division, of Martin Marietta Material Inc. Martin Marietta, an American-based company and a member of the S&P 500 Index, is a leading supplier of aggregates and heavy building materials, with operations spanning 32 states, Canada and the Caribbean. Mr. Vitols worked as the Northeast Regional Manager for W. R. GRACE & Co, a publicly traded company which produces specialty chemicals and materials and operates in over 40 countries. Mr. Vitols has a Masters of International Business (MBA) from Heriot Watt University, Edinburgh, Scotland & studied Civil Engineering Technology at Mohawk College, Hamilton, Canada.

The second game changer was an acquisition Zig and Rasool were able to pull off—securing all of the infrastructure the company needs.

In the preliminary economic assessment for the Sandtown asset, the estimated capex to acquire a drying plant, equipment storage and loadout infrastructure was US$32 million.

Select just purchased all of that for US$4.3 million……getting the assets for pennies on the dollar. That deal forever changed the future economics of this company by removing $28 million of capital that would have been required.

Here's how it happened: A local entrepreneur named Paul Tuttle and his father started a trucking company in 1986 called *Tuttle and Tuttle* Company…makes sense.

The younger Tuttle decided that he liked the margins of the sand business and acquired Ozark Premium Sand.

When the oil sector downturn hit *Tuttle and Tuttle* got hit hard—and not just the trucking business, but also the sand business.   Realizing that his future was on the trucking side of things, Mr. Tuttle made the difficult decision to let the sand business go at a difficult price.

By getting some money for the sand business Tuttle was able to put the trucking business on secure footing.

Having one surviving business is better than having two that don't—even if the exit price is tough to stomach.

Select has been using these plants since October when it started test mining and test processing. The acquisition netted Select both a wet and dry plant, a truck shop, and 26 acres of real estate frontage on the UP rail and moving equipment.

This was Game Changer #2 for Select. It took all of the big capital spending that the company had to do and almost eliminated it entirely.

Deals like this don't happen often. Select just happened to be a rare willing buyer of an illiquid set of assets at the bottom of an industry in severe distress.

A Free Option – Comstock (CSL:TSX.V)

Select owns 20 million shares of publicly traded junior called Comstock. I'm banking on no value from this, but it could turn into something at some point. Current market prices value this at about $4 million.

Select received these shares in exchange for a sale of its gold asset to Comstock. SNS owns roughly 35% of Comstock's outstanding shares with this transaction.

Comstock Metals has two gold projects with Current 43-101 resource estimates, including 500,800 of Inferred Resources and 158,300 of Indicated Resources.

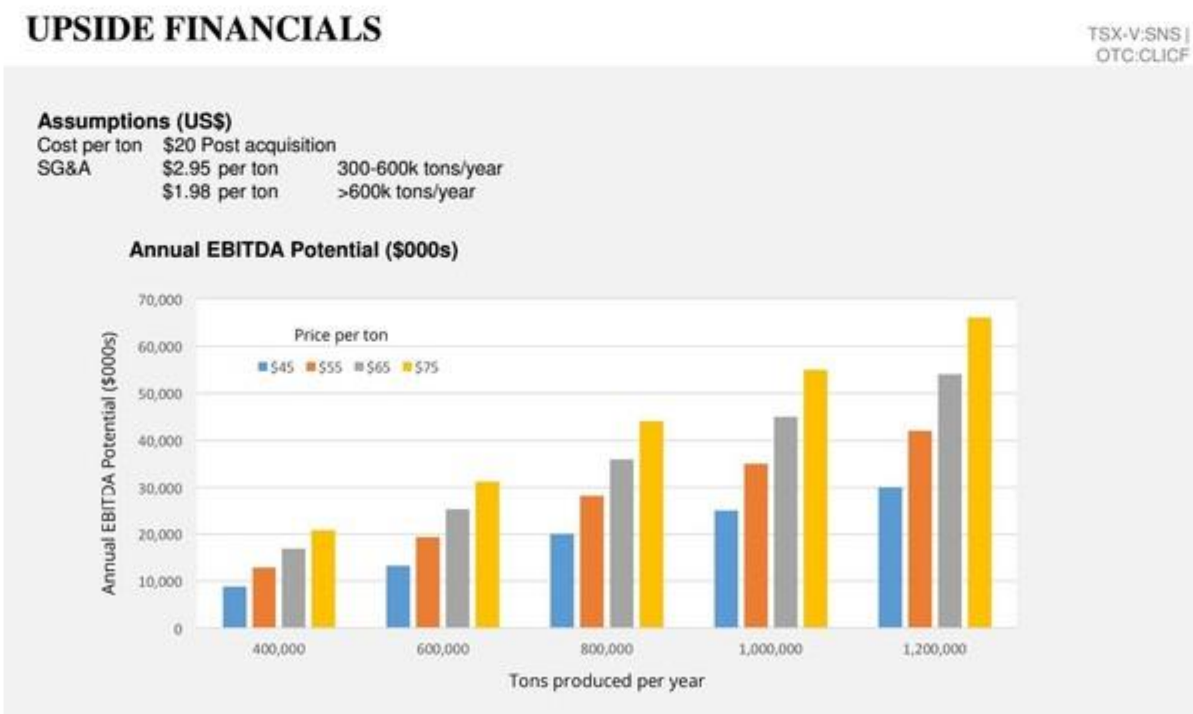
Again not counting on any value here but maybe it turns into something…

FINANCES / VALUATION

Game Changer #3 was the recent financing—US$12.5 million, which was oversubscribed. The market knows how important sand is for the energy producers and that there is a lot of growth in the years ahead. That is why the big sand players trade at 20 times EBITDA. Any stock has a lot of leverage for investors when the Market is willing to give it a 20x multiple.

Select Sands doesn't have any EBITDA at this point, but it soon will.

Current production capacity on the acquired plant is 600,000 tons per year.



EBITDA on 600,000 tons is likely going to be US$10-15 million, or Cdn $13-20 million--and that's assuming frac sand prices increase to US$45/t FOB minesite. Current enterprise value is $66 million……so that is less than 3.5x EBITDA versus 20x for the sector--assuming frac sand prices like I expect them to. (And um...I have been wrong before.)

It *potentially* gets better.

Rasool believes that for only US$2.5 million of spending, production capacity at the plant can get taken up to 1.5 million tons per year. If that happens we are talking about a company trading at 1 times EBITDA versus 20 times for the sector.

There is no guarantee of that but still……Wow!

I can’t tell you how important it is for the company and the stock that the Market understands there is no need to dilute shareholders again to accomplish this. The 600,000 ton ability already exists and cash flow from operations can fund the expansion to 1.2 or 1.5 million tons. The Market puts a cap on your stock if it knows you have to come back for more equity. To me, this means the stock can run.

The stock is telling me that it will likely run ahead of fundamentals, especially if oil holds at $50…if that happens in A Big Way I might take some partial profits. But certainly if this company executes the way management says they can…then this stock can be a multi-bagger.

With one foot firmly planted in the air, I can tell you that US$50 million of EBITDA in 3 years is a possibility. A 20x multiple gives the company an Enterprise Value of $1 billion. Divide it by 100 million shares for a $10 stock. Today it's 92 cents.

Please remember a lot of milestones must be achieved for that kind of valuation to happen. For now, the company has no debt and will still have Cdn$15 million of cash after the close of the acquisition and the final property payment.

In time, the company will most likely build its own rail transloading facility, at an estimated cost of US$3 million to save another $4/ton operating costs. At 1.5 million tons per year, this would have a roughly 6 month payback.

Rasool expects it to take about 6 months to get operations up to the 600,000 ton per year level. The Phase 2 expansion could get done by the end of 2017.

Below shows the multiples that competitors trade at.

	EMES	FMSA	HCLP	SLCA	
Price	$12.92	$8.97	$16.76	$47.87	
Shares Outstanding	24.1	162.0	49.1	63.6	
Equity Value	311.6	1,453.3	823.6	3,043.6	
Cash and ST Investments	(3.2)	(61.6)	(39.7)	(454.2)	
Total Debt	312.2	1,146.6	195.2	490.0	
Preferred equity	-	-	-	-	
Minority Interest	-	0.3	2.6	-	
TEV	$620.7	$2,538.5	$981.7	$3,079.4	
EBITDA 2016	($56.9)	($2.7)	($6.6)	$29.1	
EBITDA 2017	($15.5)	$109.8	$45.6	$154.0	
EBITDA 2018	$31.4	$250.8	$109.0	$331.1	
EBITDA 2019		$532.7	$254.2	$608.0	
					Avg
EV/EBITDA 2016	NA	NA	NA	106.0x	
EV/EBITDA 2017	NA	23.1x	21.5x	20.0x	21.6x
EV/EBITDA 2018	19.8x	10.1x	9.0x	9.3x	9.5x
EV/EBITDA 2019		4.8x	3.9x	5.1x	4.6x

WHAT THE ANALYSTS SAY

FIRM **TARGET PRICE**

The analysts aren't saying anything because there aren't any that follow this company…..yet.

STOCK CHART

CONCLUSION

Select Sands is the Holy Grail for speculative investors now—it hit the inflection point where it is becoming a real company. They have seasoned, experienced operational management. They bought assets for pennies on the dollar. Their location is closer to the Permian than most other frac sand deposits. The quality of their asset is top notch.

As a result, real investors are now taking over the float of the stock from Canadian speculators.

From a macro standpoint, the industry to move towards finer mesh sand is a big tailwind for the stock—as is finding deposits closer to the Permian, which gives Select Sands Sandtown deposit a big logistical edge in delivering a premium product at slightly discounted rates.

Now that Permian producers *AND* SCOOP/STACK producers in nearby Oklahoma have lowered costs and increased efficiencies so that they can produce profitably at US$40 WTI, the Market is confident frac sand will be in steady demand.

Aside from lower service costs, the main reason for increased efficiences are--pad drilling, downspacing, longer laterals and MORE SAND.

Sand is now considered to be in a secular bull market; it won't be cyclical. If oil prices are so low the Permian isn't working, we all have much bigger problems than a junior sand producer.

Frac sand is viewed as essential to the oil and gas industry, and pricing is now starting to improve. If finer mesh sand does go into shortage in 2017, operating margins could soar even further.

And they need to soar for this stock to be the 10 bagger I think it can be.

But this is not a slam dunk. They have everything except customers. And management has to successfully integrate the infrastructure into the asset.

Fortunately, Zig Vitols has done this before. He’s real. If he can do his job just in the market conditions that exist now for frac sand, shareholders will get paid big.

I own 150,000 shares at 77 cents.

-Keith