

EMPIRE INDUSTRIES LTD.

Price (Close Feb. 4): \$0.08
52-Week Range: \$0.15 - \$0.06
Recommendation: Spec. Buy
Target Price: \$0.15
Shares O/S (M): 259.34
Market Cap (M): \$20.75
Average Volume:
 50-Day: 126,800
 200-Day: 126,800
Year-End: December 31
Symbol: TSX-V: EIL



PROFILE: Winnipeg-based manufacturer of specialized engineered products, selling in domestic and selected international markets. The Company's primary focus is on its Media-based Attractions operations.

EMPIRE INDUSTRIES DIVESTMENT

Under a Plan of Arrangement (see below), Empire Industries Ltd. is divesting its Manufactured Products business unit into a separate company, herein referred to as "SpinCo", that will be owned 54.5% by Empire Industries' shareholders and 45.5% by a Chinese company, Excellence Raise Overseas Limited, herein referred to as "Subscriber".

Positive Attributes of the Proposed Transaction

1. It allows Empire Industries to focus on its primary business unit, Media-Based Attractions, as well as its Steel Fabrication Services division.
2. The Manufactures Products unit, comprising the hydrovac truck business that operates in Canada and the USA, and in China, will become a stand-alone public company.
3. Empire Industries has endeavoured, for more than two years, to find a progressive Chinese partner to augment its efforts to expand its hydrovac truck business in the Peoples' Republic of China (PRC).

4. The Chinese partner will contribute C\$10,000,000 by way of:
 - (a) First Subscription Receipt Private Placement (FSRPP) for US\$3,521,127, or about C\$5,000,000, subject to fulfilling certain regulatory requirements. These funds will be used to capitalize SpinCo with \$3.5 million of working capital, and to advance a subordinated shareholder loan of \$1.5 million to a newly-incorporated, wholly foreign owned enterprise (WFOE) in the PRC.
 - (b) Second Subscription Receipt Private Placement (SSRPP) for C\$2,500,000 under similar terms as the FSRPP. The proceeds will be used to increase the capitalization of WFOE with C\$2,000,000 of equity and \$500,000 of a subordinated shareholder loan. As a subsidiary of SpinCo, WFOE will carry out SpinCo's hydrovac truck business in China.
 - (c) Secured Subordinated Term Loan (WFOE Loan), to be denominated in Chinese renminbi, and equivalent to C\$2,500,000, with a four-year term and bearing an interest rate of 8%.

Value To Empire Industries

Empire Industries will spin out approximately C\$6,500,000 of fixed assets and working capital (collectively, the Net Assets) to SpinCo. In turn, Empire Industries will receive a subordinated loan, the Empire Loan, with a principal amount that is the difference between the actual book value of the spun-out assets of approximately C\$6,500,000 (the exact value will be based upon the determined value of the Net Assets on the Closing Date of the transaction) and C\$3,500,000, or approximately C\$3,000,000. The loan will have a term of 7 years and will bear interest at 2.7% per annum, repayable at C\$20,000 per month for 60 months (5 years), and with balloon payments of C\$900,000 on the anniversary of each of the sixth and seventh years.

Value To Empire Industries' Shareholders

Based upon the third party valuation by Excellence Raise Overseas Limited (the Subscriber), 100% of SpinCo is valued at C\$16,500,000, such that Empire Industries shareholders will receive shares of SpinCo worth C\$9,000,000, or \$0.035 per Empire Industries share.

Other Issues

1. A Plan of Arrangement is typically a "tax deferred" method of distributing value to shareholders. It is like a dividend-in-kind of shares, but it does not trigger the immediate taxes associated with dividends.
2. Mutual Break Fees: There are break fees payable to the other party if either Empire Industries or the Subscriber back out of the Plan of Arrangement.
3. Governance: Initially, the board of directors of SpinCo will be nominees of Empire Industries. Once the divestment transaction is concluded, the board will consist of five directors, with two nominees provided by Empire Industries, two nominees from the Subscriber, and one mutually-agreed nominee.

Editorial

COMMENT: *In both private and public meetings, CEO Guy Nelson has hinted strongly that structural changes were forthcoming at the Company. We view this proposal positively since one of the issues we have highlighted in previous reports is that, in our opinion, the Company was being penalized for being a disparate mini-conglomerate. See our full comment on the mini-conglomerate issue on the next page. While we realize that the Media-Based Attractions unit is primarily where management has been focused for growth, nevertheless a certain amount of management time and energy was undoubtedly devoted to maximizing results at the other two business units. Given that there is a certain amount of synergy between the Manufactured Products division and the Steel Fabrication Services division, it is somewhat disappointing that the two divisions could not be divested together. However, this proposal represents a big step. Now, if the Company were able to spin off the Steel Fabrication Services unit, we would have a pure-play provider of international amusement rides. In our mind, at least in the near-term after it occurred, this would be a strong positive for the Company's share price. Concurrently, it would likely draw considerably more investor interest and attention to the Company on an on-going basis.*

Set out below, we provide our commentary on Empire Industries as a mini-conglomerate. This is taken from our December 2015 Update Report (link subsequently provided) which, in turn, was initially provided in our Initiating Report of August 13, 2014. To distinguish the copied section, it is highlighted in **blue**.

Empire Industries As A Mini-Conglomerate

We wish to comment on Empire Industries as a mini-conglomerate. In our Initiating Report of August 13, 2014, we wrote the following, which is as pertinent now as it was then:

Investors may be over-looking Empire Industries because, with its three distinct business operating units, it could be perceived as a conglomerate, and conglomerates can be difficult to understand and to value. Since Empire's primary, but not exclusive, focus is on its Media-Based Attractions, which has by far the largest contribution to both Sales and EBITDA, some investors may like to see the Company hive off its Manufactured Products and Steel Fabrication businesses to crystallize their intrinsic values and simplify the firm's business operations.

There is some synergy with those two smaller divisions, since the Steel Fab division supplies the Manufactured Products division with the fabricated steel needed to manufacture the hydrovac trucks. With China's large steel industry, a similar set-up in China for these two divisions also makes sense. The common thread in the Company's operations is Steel + Engineering, together providing a design and build capability in niche markets.

COMMENT: *As with any savvy company, if Empire Industries' management deems it prudent to dispose of any segment of its operations to increase the enterprise value, we believe it would take advantage of that opportunity.*

"Unconglomerating" (if there is such a word!), or selling a business unit, while perhaps a prudent management decision, is not all that easy to accomplish, particularly in the difficult and challenging environment that we, globally, currently face. Economic conditions in the USA are definitely improving, albeit slowly, but many parts of the globe that are struggling are causing negative ripple effects on investment and corporate sentiment.

Rather than down-sizing the Company, Empire Industries may just have to continue on its current path and do the best it can until economic conditions and investor sentiment improves.

COMMENT: *Nonetheless, we believe in the Company, its management, and its prospects, and we fully expect that the Company will demonstrate this as economic conditions in Canada, and globally, improve.*

<End of mini-conglomerate section>

Update Report

eResearch issued a comprehensive Update Report on Empire Industries on December 13, 2015. Here is a link to that report: http://www.eresearch.ca/wp-content/uploads/2015/12/EIL_121315-U.pdf

Valuation

In our Update Report, we provided a comprehensive valuation section using estimated 2015 parameters. We will update our valuation section as soon as the Company issues its 2015 year-end results.

On the next page, we provide some technical charts.

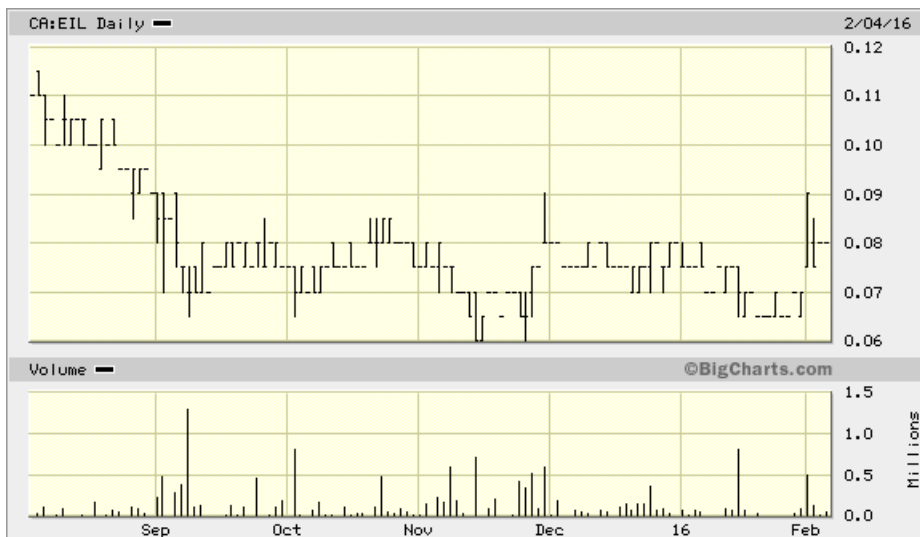
Technical Analysis

1. One-Year Chart



Observations: The blue down-trend line was broken in late November. The stock has been consolidating, since the beginning of September, in a rectangle formation, defined by the red resistance line and the green support line, between \$0.09 and \$0.065, with a couple of dips to \$6.00 in November just before it emerged above the down-trend line. The positive news of the Manufactured Products division was not catalyst enough for the stock to break free of the rectangle.

2. Six-Months Chart



Observations: There is nothing different to report on this six-months chart. It is provided to show the rectangle more clearly, including the share-trading volume

eRESEARCH CORPORATION**eResearch Analyst on this Report:**

Bob Weir, B.Sc., B.Comm, CFA

Analyst Affirmation: I, Bob Weir, hereby state that, at the time of issuance of this research report, I do own shares of Empire Industries Ltd.

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