

EMPIRE INDUSTRIES LTD.

Price (Sept. 2): \$0.085
52-Week Range: \$0.15 - \$0.07
Recommendation: Spec. Buy
Target Price:
 1st: \$0.22
 2nd: \$0.27
Shares O/S (M): 259.34
Market Cap (M): \$22.04
Average Volume:
 50-Day: 83,500
 200-Day: 176,600
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.

Second-Quarter and First-Half 2015 Results Share Consolidation Proposal

Empire Industries Ltd. reported mixed results for the second quarter (ended June 30, 2015). Net profit from continuing operations was \$0.003 per share in Q2/2015 compared with \$0.005 per share in Q2/2014, but significantly better than the loss of \$0.003 reported in Q1/2015. *Media-based Attractions* showed strong revenue growth in the quarter, offsetting declines in *Manufactured Products* and *Steel Fabrication Services*.

COMMENT: *Empire Industries reported year-over-year revenue increases for both the quarter and six-month periods ended June 30, 2015. However, strong earnings gains for both periods by the Media-based Attractions operations were adversely impacted by significantly lower results from both the Manufactured Products and Steel Fabrication Services sectors, primarily as a result of weakness in the western Canada economy. Over the balance of 2015, we believe that a continued strong performance by the Media-based Attractions business as a result of its large and growing order backlog, as well as continued strength in the U.S. dollar, will go a long way to offset the negative impact of the western Canada economic slowdown on the Company's other two operations. However, economic conditions and business activity in western Canada are highly dependent on the price of crude oil, and a near-term recovery in the oil price is far from assured. If this scenario endures, both the Manufactured Products and the Steel Fabrication Services businesses will continue to struggle.*

COMMENT: *The Company made an announcement on September 1 regarding a proposal to ask its shareholders at its AGM on September 23 to give management the authority to implement a share consolidation transaction when and “if the conditions are right”. eResearch generally does not view share consolidation transactions favourably, unless market conditions are positive. In our opinion, current market conditions are not conducive to a successful share consolidation transaction for shareholders of Empire Industries. We comment extensively with our reasons why we are opposed in an op-ed beginning on Page 9 of this report.*

In a discussion with management, we were advised that the Company’s management largely agrees with our general view on share consolidations and that the Board of Empire Industries is fully cognizant that the timing for a share consolidation transaction would take place only “if the conditions are right”.

Thus, an affirmative shareholder vote would not necessarily lead to an immediate share consolidation, but only give the Company pre-approval to implement such a program, which the Company would carry out only at the appropriate time, and when it would be in the best interests of its shareholders.

In the meantime, we discuss the H1/2015 and Q2/2015 results below and on the following pages.

H1/2015 RESULTS (January 1-June 30, 2015)

A. Comparison of H1/2015 with H1/2014

Revenues

Overall revenues increased 2.9% in H1/2015 to \$70.5 million, up from \$68.5 million a year ago. The gain reflected the impact of a 15.9% increase in *Media-based Attractions* revenue to \$43.1 million from \$37.2 million, and a 10.6% increase in *Steel Fabrication Services* revenue to \$16.0 million from \$14.5 million. These increases more than offset the 32.5% decline in *Manufactured Products* revenue to \$11.3 million from \$16.8 million.

The gain in revenue in *Media-based Attractions* reflected its strong order backlog along with the relative strength of the U.S. dollar, since virtually all of this segment’s contracts are priced in that currency. The increase in revenues in *Steel Fabrication Services* reflected the comparison of H1/2015 results with H1/2014 results, which included an abnormally weak Q1/2014. The revenue decline in *Manufactured Products* reflected the weakness in the western Canada economy, particularly in the energy and energy-services industries, and which led to reduced demand and weaker pricing for the Hydrovac truck product line.

EBITDA

EBITDA for H1/2015 fell 23% to approximately \$3.0 million from \$3.9 million a year ago. This resulted from a transition from positive to negative EBITDA margins in both *Manufactured Products* and *Steel Fabrication Services*, which more than offset an 83.5% improvement in EBITDA in *Media-based Attractions*. In the latter area, EBITDA rose in H1/2015 to \$4.707 million from \$2.565 million in H1/2014. *Manufactured Products* suffered an EBITDA decline to negative \$0.008 million from positive \$1.88 million, and *Steel Fabrication Services* incurred a decline from positive \$0.622 million to negative \$0.391 million.

Net Profit

Empire Industries reported a net profit of \$0.005 million, or \$0.00 per share, for H1/2015 compared with \$2.86 million, or \$0.01 per share, for H1/2014, down significantly with the net profit margin declining to 0.0% from 4.2%.

Table 1: Empire Industries Ltd. H1/2015 versus H1/2014 Results

<i>(\$000s except EPS)</i>	<u>H1/2015</u>	<u>H1/2014</u>	<u>Change</u>
Revenues			
Media-Based Attractions	\$43,113	\$37,206	15.9%
Manufactured Products	\$11,311	\$16,757	-32.5%
Steel Fabrication Services	\$16,016	\$14,483	10.6%
Other	<u>\$66</u>	<u>\$64</u>	<u>3.1%</u>
Total Revenues	\$70,506	\$68,510	2.9%
EBITDA			
Media-Based Attractions	\$4,707	\$2,565	83.5%
Manufactured Products	-\$8	\$1,880	-100.4%
Steel Fabrication Services	-\$391	\$622	162.9%
Other	<u>-\$1,311</u>	<u>-\$1,174</u>	<u>-11.7%</u>
Total EBITDA	\$2,997	\$3,893	-23.0%
EBITDA Margin			
Media-Based Attractions	10.9%	6.9%	
Manufactured Products	-0.1%	11.2%	
Steel Fabrication Services	-2.4%	4.3%	
Other	<u>n/m</u>	<u>n/m</u>	
Total EBITDA Margin	4.3%	5.7%	
Net Profit from Cont. Ops.	\$5	\$2,860	n/m
Net Profit Margin	0.0%	4.2%	
EPS	\$0.000	\$0.011	n/m
Average Shares O/S (million)	258.5	254.4	1.6%

Source: The Company and eResearch.

On the next page, we analyze the Q2 results, comparing Q2/2015 with Q2/2014.

After that, we compare Q2/2015 with Q1/2015.

Q2/2015 RESULTS (April 1-June 30, 2015)

B. Comparison of Q2/2015 with Q2/2014

Revenues

Total revenues increased 6.8% in the quarter to \$37.3 million, compared with \$34.9 million in Q2/2014. The increase reflected a strong 47.3% gain in revenues in the *Media-based Attractions* business to \$24.5 million from \$16.6 million a year ago. This gain more than offset declines in revenue of 19.6% in the *Manufactured Products* sector to \$6.7 million from \$8.3 million, and a 38.8% reduction in revenue in the *Steel Fabricated Services* operation from \$9.9 million to \$6.1 million over the same period.

The strong revenue gain in *Media-based Attractions* reflected the benefit of a continued increase in new contracts generated by these operations, while the lower revenues in the *Manufactured Products* sector and *Steel Fabrication Services* operations reflected the impact of current economic problems in western Canada.

EBITDA

EBITDA declined 2.5% in the quarter to \$1.485 million, down from \$1.523 million a year ago. An increase in EBITDA in *Media-based Attractions* to \$2.566 million from \$0.295 million was more than offset by declines in EBITDA in the Company's other operations over the same period. In the *Manufactured Products* operation, EBITDA declined to \$130 million from \$786 million a year ago, while in the *Steel Fabrication Services* sector EBITDA declined to negative \$0.470 million from positive \$1.054 million.

Net Profit

Empire Industries reported net profit from continuing operations in Q2/2015 of \$0.890 million, or \$0.003 per share, down 46% from \$1.649 million, or \$0.005 per share, in Q2/2014. In Q2/2015, the net profit margin declined to 2.4% from 4.7% a year ago, reflecting lower EBITDA in Q2/2015 together with a \$0.275 million reversal of a previously-accrued tax recovery.

Backlog

The Company's current order backlog of \$180 million is well above the December 2014 level of \$155 million and June 2014's \$104 million. The latest backlog does not include the \$70 million Thirty Meter Telescope (TMT) contract which the Company is currently negotiating.

Table 2, on the next page, shows the comparison of Q2/2015 and Q2/2014 results.

Table 2: Empire Industries Ltd. Q2/2015 versus Q2/2014 Results

<i>(\$000s except EPS)</i>	<u>Q2/2015</u>	<u>Q2/2014</u>	<u>Change</u>
Revenues			
Media-Based Attractions	\$24,471	\$16,613	47.3%
Manufactured Products	\$6,686	\$8,316	-19.6%
Steel Fabrication Services	\$6,089	\$9,951	-38.8%
Other	<u>\$51</u>	<u>\$32</u>	<u>59.4%</u>
Total Revenues	\$37,297	\$34,912	6.8%
EBITDA			
Media-Based Attractions	\$2,566	\$295	769.8%
Manufactured Products	\$130	\$786	-83.5%
Steel Fabrication Services	-\$470	\$1,054	-118.3%
Other	<u>-\$741</u>	<u>-\$612</u>	<u>21.1%</u>
Total EBITDA	\$1,485	\$1,523	-2.5%
EBITDA Margin			
Media-Based Attractions	10.5%	1.8%	
Manufactured Products	1.9%	9.5%	
Steel Fabrication Services	-7.7%	10.6%	
Other	<u>n/m</u>	<u>n/m</u>	
Total EBITDA Margin	4.0%	4.4%	
Net Profit from Cont. Ops.	\$890	\$1,649	-46.0%
Net Profit Margin	2.4%	4.7%	
EPS	\$0.003	\$0.005	-40.0%
Average Shares O/S (million)	258.7	254.9	1.5%

Source: The Company and eResearch.

Q2/2015 RESULTS (April 1-June 30, 2015)

C. Comparison of Q2/2015 with Q1/2015

Revenues

Total revenues increased 12.3% quarter-over-quarter (Q/Q) to \$37.3 million, compared with \$33.2 million in Q1/2015. The increase reflected a strong 28.9% gain in revenues in the *Media-based Attractions* business to \$24.47 million from \$18.99 million in the previous quarter. The *Manufactured Products* sector saw revenue rise 44.6% Q/Q to \$6.69 million from \$4.63 million. The *Steel Fabricated Services* operation recorded a revenue drop Q/Q of 36.5%, to \$6.09 million from \$9.58 million.

EBITDA

EBITDA was a different story. Total EBITDA, from Q1 to Q2, declined very slightly, to \$1.485 million from \$1,512 million, or 1.8%. EBITDA in *Media-based Attractions* increased 19.9% Q/Q to \$2.566 million from \$2.140 million. *Manufactured Products* reported a notable gain, but the EBITDA is a small number. It rose to \$0.130 million from a negative \$0.136 million. Likewise for the *Steel Fabrication Services* sector where EBITDA declined to negative \$0.470 million from a positive \$0.079 million.

EBITDA Margin

The overall margin in Q2/2015 was 4.0%, down from 4.6% in Q1/2015. *Media-based Attractions* recorded a margin decline to 10.5% from 11.3%. *Manufactured Products* saw its EBITDA margin improve Q/Q, while *Steel Fabrication Services* suffered a significant margin drop.

Net Profit

Empire Industries reported net profit from continuing operations in Q2/2015 of \$0.890 million, or \$0.003 per share, which was significantly better than the loss of \$0.885 million, or \$0.003 per share, incurred in Q1/2015. In Q2/2015, the net profit margin was a positive 2.4% compared with a negative 2.7% in Q1/2015.

The table comparing Q2/2015 with Q1/2015 is presented on the following page.

Table 3: Empire Industries Ltd. Q2/2015 versus Q1/2015 Results

<i>(\$000s except EPS)</i>	<u>Q2/2015</u>	<u>Q1/2015</u>	<u>Change</u>
Revenues			
Media-Based Attractions	\$24,471	\$18,985	28.9%
Manufactured Products	\$6,686	\$4,625	44.6%
Steel Fabrication Services	\$6,089	\$9,584	-36.5%
Other	<u>\$51</u>	<u>\$15</u>	<u>240.0%</u>
Total Revenues	\$37,297	\$33,209	12.3%
EBITDA			
Media-Based Attractions	\$2,566	\$2,140	19.9%
Manufactured Products	\$130	-\$136	-195.6%
Steel Fabrication Services	-\$470	\$79	n/m
Other	<u>-\$741</u>	<u>-\$571</u>	<u>-29.8%</u>
Total EBITDA	\$1,485	\$1,512	-1.8%
EBITDA Margin			
Media-Based Attractions	10.5%	11.3%	
Manufactured Products	1.9%	-2.9%	
Steel Fabrication Services	-7.7%	0.8%	
Other	<u>n/m</u>	<u>n/m</u>	
Total EBITDA Margin	4.0%	4.6%	
Net Profit from Cont. Ops.	\$890	-\$885	n/m
Net Profit Margin	2.4%	-2.7%	
EPS	\$0.003	-\$0.003	n/m
Average Shares O/S (million)	258.7	258.2	0.2%

On the next page, we show the last eight quarters and the last five annuals, plus the trailing twelve months (TTM).

QUARTERLY TRENDS

The table below shows the quarterly trend in selected financial items for the past eight quarters.

Table 4: Empire Industries Ltd. Quarterly Results Q3/2013 to Q2/2015

<i>(\$000s except EPS)</i>	<u>Q3/13</u>	<u>Q4/13</u>	<u>Q1/14</u>	<u>Q2/14</u>	<u>Q3/14</u>	<u>Q4/14</u>	<u>Q1/15</u>	<u>Q2/15</u>
Revenues	\$34,120	\$31,495	\$33,708	\$34,912	\$36,522	\$36,124	\$33,209	\$37,297
EBITDA	\$2,090	\$1,192	\$2,370	\$1,523	\$2,263	\$1,847	\$1,512	\$1,485
EBITDA Margin	6.1%	3.8%	7.0%	4.4%	6.2%	5.1%	4.6%	4.0%
Net Profit from Cont. Ops.	\$1,648	\$726	\$1,211	\$1,649	\$732	\$2,472	-\$885	\$890
Net Profit Margin	4.8%	2.3%	3.6%	4.7%	2.0%	6.8%	-2.7%	2.4%
EPS	\$0.010	\$0.005	\$0.005	\$0.005	\$0.005	\$0.009	-\$0.003	\$0.003
Average Shares O/S (million)	247.2	250.2	253.9	254.9	255.6	256.9	258.2	258.7

Source: The Company and eResearch.

HISTORICAL RESULTS

The table below shows selected financial results for the past five years and trailing twelve months (TTM) ended June 30, 2015.

Table 5: Empire Industries Ltd. Abbreviated Historical Financial Results

Year Ended December 31	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	TTM to Jun 2015
<i>(\$000s except EPS)</i>						
Revenues	\$50,002	\$54,058	\$83,690	\$117,795	\$141,156	\$143,152
EBITDA	\$1,675	-\$3,868	\$1,952	\$6,318	\$8,003	\$7,107
EBITDA Margin	3.3%	-7.2%	2.3%	5.4%	5.7%	5.0%
Net Profit from Cont. Ops.	-\$1,976	-\$6,223	\$948	\$4,419	\$6,064	\$8,929
Net Profit Margin	-4.0%	-11.5%	1.1%	3.8%	4.3%	6.2%
EPS	-\$0.02	-\$0.04	\$0.01	\$0.02	\$0.02	\$0.03
Average Shares O/S (million)	91.2	152.5	193.2	223.2	255.7	257.4

Source: The Company and eResearch.

ABOUT EMPIRE INDUSTRIES

Empire Industries Ltd. is a manufacturer of specialized engineered products, which the Company sells in domestic and selected international markets. The Company's operations are conducted in three business sectors:

1. Media-based Attractions.
2. Manufactured Products, and
3. Steel Fabrication Services.

Empire Industries also has two key equity partnerships:

1. A 49% interest in ACE Industrial Services, which operates in the oil sands industrial maintenance services market; and
2. A 45% interest in a Chinese steel fabrication joint venture, Dongguan Qiguang Dynamic Steel Structures, Ltd., in the Asian steel fabrication market.

OUTLOOK

Empire's *Media-Based Attractions* sector is expected to continue to benefit from strength in the theme park attractions market, as indicated by the Company's recent contract awards in this area.

The *Manufactured Products* operations are currently being adversely affected by a reduced order backlog and lower throughput and pricing for hydrovac trucks. Measures are being taken to expand sales efforts into the U.S.A.

The *Steel Fabrication Services* operations are expected to experience increased competition in Alberta, as a result of reduced capital spending in western Canada resulting from the downturn caused by the oil price decline.

SHARE CONSOLIDATION

Empire Industries announced on September 1, 2015 that it will ask shareholders at its Annual and Special Meeting to be held on September 23, 2015 to consider a share consolidation of not more than a basis of 1-for-10. That is, existing shareholders will own one (1) post-consolidation share for each ten (10) pre-consolidation shares presently owned, or whatever share consolidation basis is approved, if any, at the meeting.

It is important to note that, at this time, management is seeking shareholder approval ONLY for the authority to implement a share consolidation, but not necessarily the decision to proceed with one until it is the appropriate time and only *if the conditions are right*. In this respect, in 2008, the Company was granted the authority to complete a share consolidation but, since conditions deteriorated after authority was given, the Board of Directors considered all of the factors carefully and exercised its best judgement to the extent that the consolidation was never effected.

COMMENT: *eResearch, generally, is not in favour of a company conducting a share consolidation transaction, unless stock market conditions are favourably disposed towards stocks generally and unless the company carrying out the share consolidation is expected to issue a series of positive corporate developments over the ensuing few months. In this respect, the management of Empire Industries is fully in agreement with our view, and we firmly believe that the Company's Board will not ratify a share consolidation unless it is convinced that "conditions are right" and that it is in the best interests of its shareholders.*

We understand the reasons behind the Company's management/Board of Directors proposing share consolidations, since a higher share price: (1) makes the company look more prosperous and attractive to institutions, many of which are prohibited from owning shares of companies that trade below a certain threshold, usually \$1.00 or \$2.00 per share; (2) allows stock-brokers to recommend purchase of the shares which they are usually prohibited from doing when shares are trading at very low prices; and (3) improves the Company's share trading liquidity.

<continued>

Unfortunately, despite the best intentions, it is usually the case that, in the absence of any positive corporate news immediately following a share consolidation, the shares decline from lack of investor interest, and often decline to levels approaching where they traded before the consolidation took place. That means that if the stock was trading at \$0.08 pre-consolidation and the consolidation basis was 1 for 10, the shares immediately after consolidation would be expected to trade for \$0.80 (\$0.08 times 10). What then happens if there is a dearth of corporate news is that it causes investor apathy towards the shares and they fall in price, even possibly towards and approaching where they started prior to the consolidation taking place.

If a company is performing well, experiencing good demand for its products and/or services and resulting in a rising trend in earnings, then that company's shares will, accordingly, perform well. For Empire Industries, with its three diverse business units, through no fault of its own, currently is facing considerable challenges. Economic conditions in western Canada are likely to remain extremely difficult for the foreseeable future. This will obviously impact Empire Industries' Manufactured Products and Steel Fabrication Services businesses, and the Media-based Attractions unit, which right now is doing really well, will not be able to carry the Company solely on its own. In addition, the Company's initiatives in China, which are sound enterprises in their own right, may take longer to come to fruition as that country struggles to regain its economic progress, meaning the Company's steel business may face increasing head-winds.

Therefore, we do not believe the time is right for the Company to execute a share consolidation transaction. In this respect, we believe that management and the Board will wait for a more favourable time to implement such a program, when a share consolidation transaction might be a well-timed strategy.

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 (just a little over a year ago), 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.*

RECOMMENDATION AND TARGET PRICE

eResearch recommends the shares of Empire Industries as a Speculative Buy. The shares are currently trading at \$0.075. Our first Target Price is \$0.22, and our second is \$0.27.

eRESEARCH CORPORATION

eResearch Analysts on this Report: Bill Campbell, B. Comm.; and Bob Weir, B.Sc., B.Comm, CFA

Analyst Affirmation: I, Bill Campbell, hereby state that, at the time of issuance of this research report, I do not own, directly or indirectly, shares of Empire Industries Ltd. I, Bob Weir, hereby state that, at the time of issuance of this research report, I do own shares of Empire Industries Ltd.

NOTE: eResearch reports on Empire Industries Ltd. and other companies are available FREE on our website at www.eresearch.ca. You must REGISTER to access these reports.

eResearch Corporation

eResearch was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (*subscription is free!!!*) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eresearch.ca.

eResearch Disclaimer

eResearch accepts fees from the companies it researches (the "Covered Companies"), and from financial institutions or other third parties. The purpose of this policy is to defray the cost of researching small and medium capitalization stocks which otherwise receive little or no research coverage.

To ensure complete independence and editorial control over its research, eResearch follows certain business practices and compliance procedures. (1) Fees from Covered Companies are due and payable prior to the commencement of research. (2) Reports issued subsequent to the Initiating Report are not reviewed in advance by Company management.

Empire Industries Ltd. paid eResearch a fee to have it conduct research on the Company on an Annual Continuous Basis.

In keeping with the policies of eResearch concerning its strict independence, all of the opinions expressed in this report, including any determination of a 12-month Target Price or selection of a Recommendation (Buy-Hold-Sell) for the Company's shares, are strictly those of eResearch, and are free from any influence or interference from any person or persons at the Company.

eResearch Intellectual Property

No representations, express or implied, are made by eResearch as to the accuracy, completeness or correctness of its research. Opinions and estimates expressed in its research represent eResearch's judgment as of the date of its reports, are subject to change without notice, and are provided in good faith and without legal responsibility. Its research is not an offer to sell or a solicitation to buy any securities. The securities discussed may not be eligible for sale in all jurisdictions. Neither eResearch nor any person employed by eResearch accepts any liability whatsoever for any direct or indirect loss resulting from any use of its research or the information it contains. This report may not be reproduced, distributed, or published without the express permission of eResearch.