Prepared by:
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# Empire Industries Ltd.
# (EIL.V 6.5 cents)

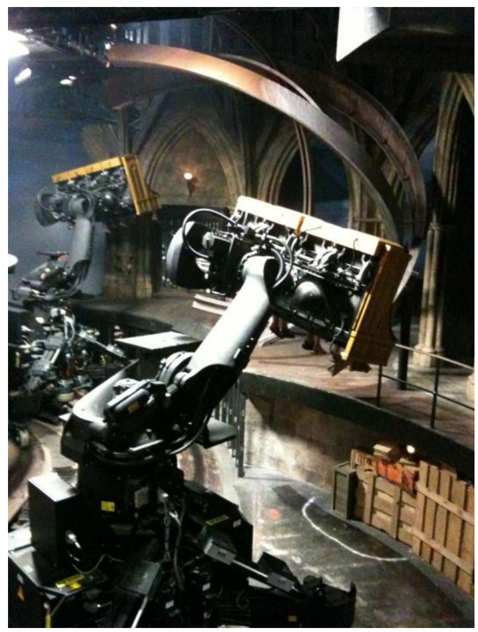
## September 11th, 2013

**"Anything You Can Dream - We Can Build"**

Empire provides investment exposure to large International Engineering Projects, Steel Fabrication, Entertainment Growth in China, and the Alberta Oil sands.

Division Websites:

www.empind.com www.empireds.com
www.parrmetal.com www.qdsjv.com/en/
www.ace-ind.com www.dynamicattractions.com



Shares outstanding include $3M strategic financing from China closed in July (the significance of which is discussed at the end of this report).

Shares Outstanding: 253M (insiders control just over 50%)

Market Cap at 7 cents = $18M
Net Book Value: $13M Book Value Per Share: approx. 5 cents

Revenue Q1: $24 Million Q2: $28 Million
Net Income for 6mth ending June 30$^{th}$: $2M or 1 cent per share

July Cash & Receivables: $22M / Approx. Payables: $11M

Customer Deposits are shown as Deferred Revenue and can be used in part to finance growth: $12M to end of June.

**Order Backlog**:  $115 Million to the end of June + $28 million in two new contracts signed in August.

Empire went public in 2006 through the TSX-V capital pool system and after several years of acquisitions they sold off their steel fabrication business in Canada. The business model now consists of:

1) Engineered Products - proprietary products targeting growth markets both domestically and internationally. This includes industrial equipment, world class amusement park rides and industry leading hydro vac trucks. The amusement park business (Internationally) may become a significant driver of growth as the company is recognized as being a world leader in this area.

2) Differentiated Steel Fabrication - focused on massive infrastructure requirements at the Alberta Oil sands. Empire has a 49% partnership in Ft McMurray with the largest first nations group in the region plus the company has a 45% partnership in China for steel fabrication (Qiguang Dynamic Structures)

**History & Restructuring**

The steel fabrication business is what was taken public in 2006. The economy by 2008 made that business very difficult due to price competition and rising strength in the Canadian dollar. After the economic crisis hit in Q4 2008, the company spent several years selling off unprofitable divisions.

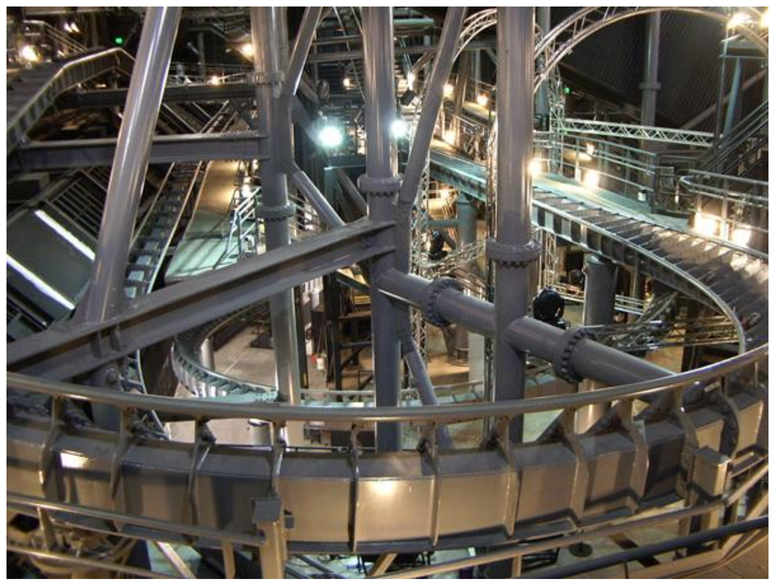
After going public Empire spent almost $80 million on eight acquisitions. Over the past couple years **as the smoke settled on dispositions, Empire was left with the best of the lot** and they are now moving forward with a leaner (and wiser) company that is focused on rebuilding shareholder value through high growth International opportunities.

Originally Empire was a Canadian commodity (steel) business. Now that capacity is being replaced through a Chinese joint venture signed in May 2013. This JV will capitalize on their intellectual property and process as one of their original acquisitions was a steel fabrication company that has been **in business since 1926.** This JV brings down their cost of steel fabrication considerably. In Canada the steel manufacturing industry is far too competitive with small margins.

## **Dynamic Structures - A Significant Area of Growth**

- Acquired by Empire in 2007
- Fabricating steel since 1926 and the world's leader in telescope fabrication (1975) for universities and government. More than half the world's telescopes or enclosures were built by Dynamic
- Commenced amusement park ride manufacturing in 2000.
- Over 50 Dynamic custom built amusement rides are currently in use around the world
- Rides use a combination of various advanced elements including Robotics
- Engineers are amongst the most talented in the world at building complex structures and systems

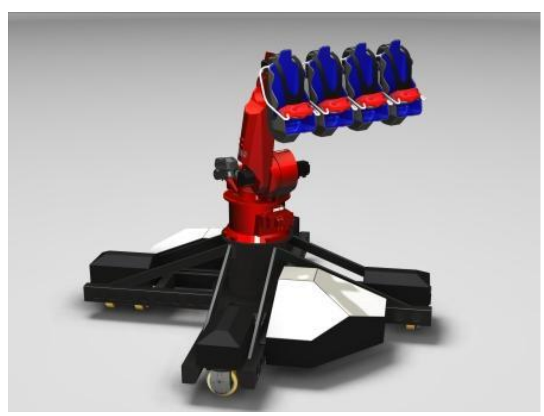
**Telescopes are an old school business that will begin to revive itself over the next five years** as universities and governments budget replacements and upgrades that haven't been necessary for well over a decade. During that slowdown period (following the initial build out phase) Dynamic took that same engineering expertise to create some of the world's most advanced amusement park rides and attractions.



**> Dynamic Attractions**

Dynamic Attractions was formed about two years ago. This allowed the company to take their expertise in amusement park rides and create proprietary rides and attractions. Their expertise in this area is demonstrated by their Harry Potter ride at Disneyworld in Florida - consistently ranked as one of the world's most popular amusement park rides.

**Now Empire is using their own proprietary ride designs to grow their Dynamic Attractions business.** They will continue to build for companies like Disney and Universal (who have their own designs) but Dynamic has their own arsenal of mind and body bending designs.



http://www.empind.com/portfolio/category/new-designs

**The potential in China alone is note-able**. Other than Hong Kong Disneyland, there is next to nothing for quality entertainment of this nature in mainland China. Yet several hundred million people are gaining more and more wealth. Families want to be entertained, and companies will be more than eager to find ways for them to spend their money.

The potential of this new business model has been demonstrated since May 2013.

- May 2nd a $30 million ride contract was signed for a major theme park in the United States
- August 6th an $18 million ride contract was signed for China
- August 8th a $9.5 million ride contract was signed for China

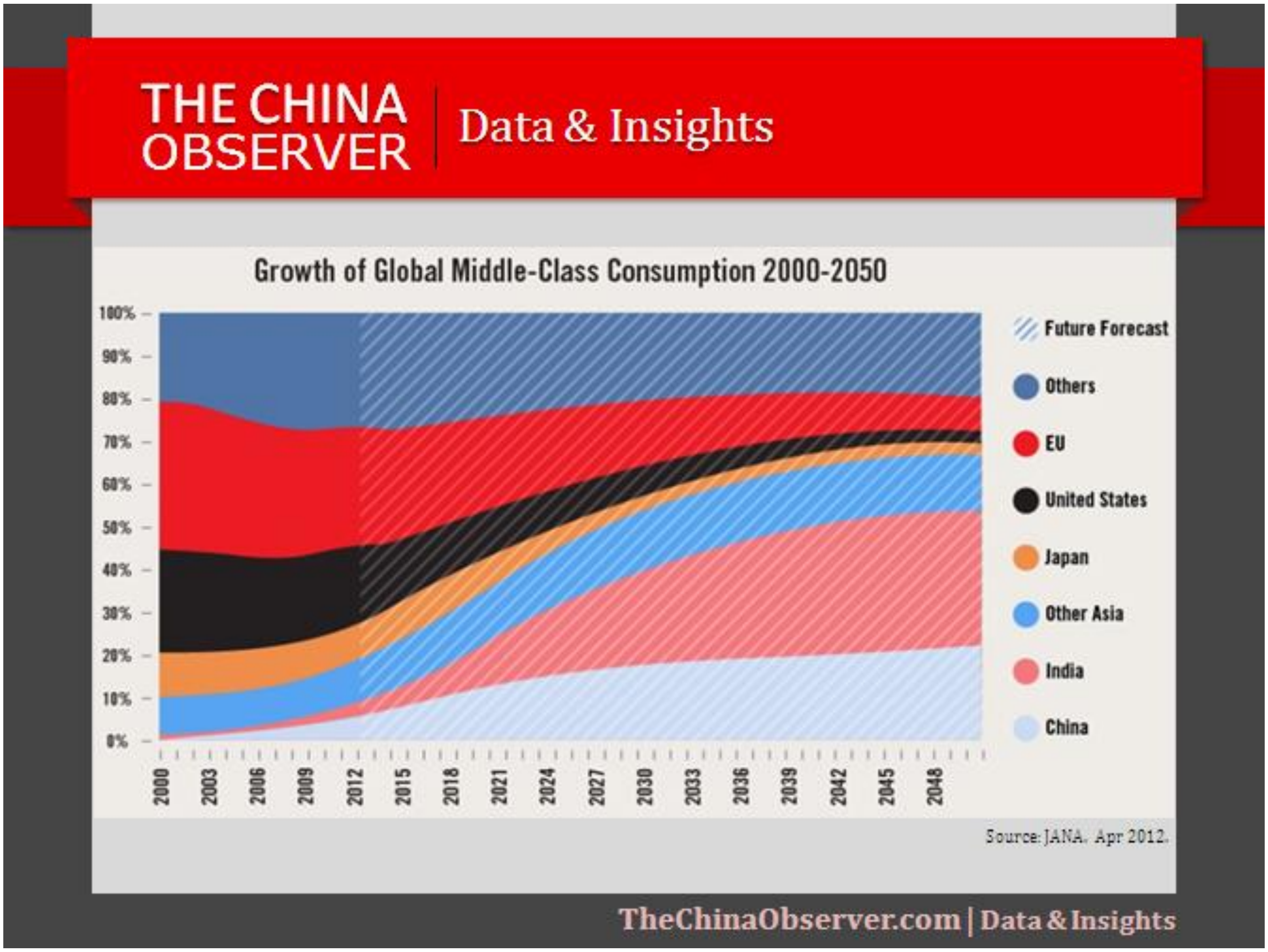
"Dark" rides (operating indoors) have been proven by Disney & Universal to be the most popular amongst park visitors. For this reason Empire (Dynamic Attractions) has focused on this type of ride design for their own proprietary products. Rides of this nature are very family orientated to attract the largest possible revenue for the park operator. They are designed to take the rider to the "edge of the thrill" but then bring them back without ruining their experience.

The company will generate revenue on the initial capital cost plus long term maintenance contracts and parts.

## The Consumer in China

In North America consumer spending represents about 70% of the economy**. In China the consumer currently represents only 30% of the economy**. For decades China has grown its economy through exports. That will continue but a much larger percentage of their economy will now depend upon consumer spending "internally". With 1.3 Billion people and a **middle class estimated to be 300 to 400 million people**, the amount of money to be spent at home is enormous.

The amusement park model has been well proven globally and because **high quality amusement park rides are almost non-existent across China**, the opportunities for Empire in this country may be significant. If you reference the chart below, you will also see where **India** (over time) may become another significant market for them.




**Tornado Hydro vac Division**

- Designed and manufactured since 1984 (Alberta based)
- One of the highest quality trucks in North America and one of the most popular
- Hydro vac trucks use high pressure water to remove soil and liquids around infrastructure and utilities. It is used extensively in the oilfield and can serve as a giant vacuum for liquids, mud, debris, etc. Many cities own or depend on them.
- Over 400 Tornado units in service

- Trucks typically sell for $1/2 million (Empire builds the backend on an existing truck chassis)
- The company makes five or six per month and they are currently sold out until the end of 2013

**China is the largest excavation and construction market in the world so Empire will be taking this truck design and technology to China where it has rarely been seen**. Because the Tornado Hydro vac has become an industry benchmark in North America, it should be very well received.

In any modern community or construction project (including plants and processing facilities), using a hydro vac truck is the only excavation method available where the user is guaranteed not to destroy underground wires, small diameter piping or fiber-optic cables.

__Differentiated Steel Fabrication Operations__

**Empire Iron** - based in Edmonton has been doing structural steel fabrication and installation since 1956

**Dynamic Structures** - based in Vancouver and discussed above. In addition to engineering they do structural, mechanical and electrical.

**Parr Metal** - based in Winnipeg has been fabricating steel and aluminum pressure vessels and tanks since 1976

**Qiguang Dynamic Steel Structures** - a new joint venture established in China with a 120,000 sq.ft steel manufacturing plant (expansion possible to ½ million sq.ft). All capacity closed in Canada was replaced in China.

**ACE Industrial** - based in Ft McMurray since 1989 does machining, welding and steel installation. This is an aboriginal joint venture with the Athabasca Chipewyan First Nation. This division turned the corner to profitability in 2012. Growth potential here is also significant given the size of oil sands projects and the fact Empire's **Chinese steel may eventually allow them to bid on large Ft Mac construction projects**. ACE's joint venture partner employs over 3000 people.

## Strategic Financing Related to China

One of the primary concerns I have with "any" company is their share structure and Empire is no different. Heading into 2013 Empire had 193 million shares outstanding. Fortunately insiders held a large percentage of that, but it is still a large number.

The low share price helps offset that high number so it is not a major issue for the time being. However, it weighs on the earnings per share (EPS) valuation – although we "are" dealing with a penny stock, not a blue chip.

To add fuel to this share structure concern, the company did a 60 million share financing at 5 cents (with a 10 cent warrant) in May 2013. Under normal circumstances this would have been enough to have me ignore the company entirely.

Fortunately this was far more strategic than anything else. Insiders of the company subscribed for 9.6 million units or 16 per cent. The remainder went to a very important and influential Chinese investor who will help them dramatically in China.

Junliang Xie through a holding company purchased 50.4 million units giving him control over 19.9% of the shares outstanding and pushing insider control over 50%.

Mr. Xie is a **director of three private equity funds in China**. He is also the **managing director of a recently created China based $800-million private equity fund** called the Zhoushan Restructuring Private Equity Fund.

This strategic financing also opens the door to creation of a new company they would establish (owned 51% by Empire) that would license certain intellectual property and target large construction projects in the City of **Zhoushan** (south of Shanghai). Here a new economic zone is being created by the Chinese government and in the past, **construction spending within these zones has been enormous.**

**Market Opportunity**

A corporate presentation in May by the CEO identified the following areas of growth in addition to what I have discussed above.

- Leverage their world class design capabilities in Asia and Western Canada
- Leverage their ability to create the best rides in the world using their own proprietary attraction products targeting the rapidly growing Chinese middle class.
- Leverage contacts and strategic partners in China
- Realize cost savings for oil sands clients by optimizing the steel supply chain plus provide maintenance services to Ft McMurray corporations and oil sands producers.

**Empire's Strategy to Create Shareholder Value:**

- Capitalize on proprietary and break-through technologies along with long established industry reputation in precision fabrication.
- Increase exports to Asia from Canada of proprietary entertainment attractions
- Provide support services from Canada to strengthen manufacturing in China and ensure those products meet Empire's strict Canadian standards.
- Capitalize on opportunities in the growing oil sands market (steel and maintenance)
- Accelerate an increase in overall profitability from their core businesses

**Conclusion**

Because Empire jumped into the steel fabrication business in 2006 and spent years struggling financially, the broader investment community has ignored them. My objective with following them at this stage is to speculate before the herd and try to find a comfortable balance between risk & reward.

**If that judgement call proves correct, we could make substantial percentage gains on a 7 cent stock** – even when the share structure is less than ideal. Empire also provides attractive diversification from micro cap resource exploration plays.

While they are still early in their financial turnaround, they have now produced positive earnings over the past two quarters. The Dynamic Attractions business should generate higher profit margins than they have achieved under pure steel fabrication and the expansion into Asia will hopefully open up a large niche market for them – not to mention the new market for selling hydro vac trucks.

The steel fabrication joint venture in China should also allow Empire to compete on Ft McMurray projects. They first need to meet certain certifications but I believe an important hurdle has already been crossed with respect to welding certification to Canadian standards.

What we will be looking for going forward are big project announcements and continued improvement to their bottom line. While they have returned to profitability, their earnings are still very small when you consider the large top line revenue.

With respect to fair valuation, it is difficult to estimate. The market cap of the company is currently $18 million and it trades near net book value. Yet this is a company doing $100 million plus in annual revenue with an order backlog approaching $150 million half way through 2013.

They have limited (if any) analyst coverage and often those brokerage targets are grossly off the mark anyway. I think if we look at the sum of their individual parts combined with the strong top line revenue, proprietary products and technology, and growth potential, we can make a strong case for a much higher valuation in 2014 and 2015.

Yet that will also depend upon how they capitalize on their expansion into China and whether or not they can make a (lot) more money from these high value contracts. It will also depend upon how they manage their share structure going forward. It made sense to issue the cheap paper in May because it was going to a strategic investor who now has a large vested interest in seeing the company succeed and grow its share price. However, any further excessive dilution and it would become a large red flag. It is something we need to watch for.

Otherwise, the stock has very good liquidity near 7 cents and **it appears this 6 to 7 cent range is very attractive risk given the upside growth potential.** My plan (at this stage) is to follow them through 2014 in hopes they continue to sign big projects and improve their bottom line.

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