



Tox Free BUY

Current Price: **\$1.54**
Valuation: **\$2.07**

Ticker: **TOX.ASX**
Sector: **Resources Services**

Shares on Issue (m): **69.8**
Market Cap (\$m): **107.6**
Net Debt (Cash) (\$m)*: **41.9**
Enterprise Value (\$m): **149.4**

* estimate post BB acquisition

52 wk High/Low: **\$2.65** **\$1.45**
12m Av Daily Vol (m): **0.10**

Key Metrics

	09F	10F
EV/EBITDA (x)	5.74	5.22
P/E (x)	10.19	8.56

Ratios

	08A	09F	10F
ND / Equity	51%	86%	41%
EBITDA Mgn	41%	34%	34%
RoA	19%	20%	22%
RoE	19%	25%	22%

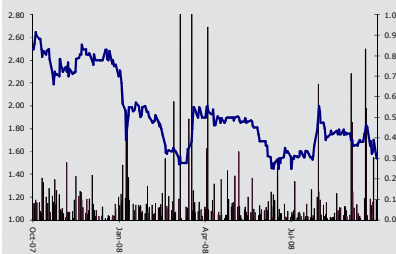
Financials:

	08A	09F	10F
Revenue (\$m)	33.8	77.3	83.6
EBITDA (\$m)	13.6	26.0	28.6
NPAT (\$m)	6.7	10.8	12.8
Net Assets (\$m)	33.1	43.8	58.0
Op CF (\$m)	6.8	15.2	19.9

Per Share Data:

	08A	09F	10F
EPS (cps)	9.4	15.1	18.0
DPS (cps)	0.0	0.0	0.0
Div Yield	0.0%	0.0%	0.0%
NTAPS (cps)	14.0	25.0	43.9
CFPS (cps)	10.0	21.8	28.2

Share Price Graph



Analyst:
Ian Christie, CFA

14 October 2008

Clean and Simple

TOX is one of Australia's largest integrated waste management and environmental service businesses with a focus on the provision of industrial and hazardous waste treatment, contaminated site remediation and industrial services.

It is a defensive business, with strategically located facilities and licences providing significant barriers to entry. The Company also boasts growth opportunities through its well-placed operations in north-west WA, where considerable resource related development is taking place.

In addition, the recent acquisition of Barry Brothers (a niche player in industrial waste) increases scale and penetration on the east coast, as well as the potential to realise synergies and cross-sell services countrywide. However, as with any large acquisition, the integration of the business needs to be carefully managed.

TOX now provides a broad range of services to a wide range of clients across Australia. The number of sites has doubled to 25 in just over a year, and the expanded geographic reach provides considerable diversification benefits and growth options.

The group generates very healthy margins, and despite some erosion following the acquisition of the lower margin Barry Brothers' business, will still remain at highly attractive levels in FY2009 (down from 41% but still in excess of 30% at the EBITDA line). The higher gearing (the Barry Brothers acquisition was debt funded) is manageable (interest cover above 5x in FY2009), and helps provide an attractive return on equity of 25% this year.

Argonaut has been impressed by TOX's recent performance, as well as its operations and management (Argonaut has visited both the Company's head office, and the Kwinana and Henderson sites recently). Growth opportunities are available, while its diversified services and broad geographic reach provide a defensive quality that helps reduce the downside risks.

Argonaut expects revenue to more than double this year and a 60% increase in NPAT. As the acquisitive growth is being debt funded, EPS is expected to grow by a similar amount.

A DCF based calculation provides a valuation of \$2.07 per share, which is 13.7x FY2009 earnings and is 34% ahead of the current share price. This reflects TOX's high margins, defensive qualities and growth potential. TOX's clean and simple business should help keep investors out of harm's way in the current toxic equity environment.

Initiating Coverage with a BUY

Key Investment Points

TOX is a defensive business

TOX is a defensive business (waste happens!), with licensing requirements providing significant barriers to entry at certain locations. For example the Company has the only incinerator in WA at Port Hedland, is the only licensed hazardous waste operator north of Geraldton, and has the only license to treat contaminated soils at a fixed plant in Australia.

..... yet boasts growth opportunities

The Company also boasts growth opportunities through its well-placed operations in the North West of WA. Considerable resource-related development is taking place both onshore and offshore in the region. While TOX does not provide a geographic breakdown of performance, Argonaut suspects that the operations in North West WA generate the highest margins, and also provide the group with the greatest growth opportunities.

..... Australia wide following the Barry Brothers acquisition

The recent acquisition of Barry Brothers (a niche player in industrial services) also provides opportunities to increase scale and penetration on the east coast. Synergies and cross selling opportunities provide potential to enhance revenue growth, although the risks associated with integration need to be managed carefully.

The business has generated very healthy margins in the past (EBITDA margin >40% and NPAT margin >20% in 2008), although these will be eroded by the Barry Brothers acquisition (but still >30% at the EBITDA level and in the mid teens for NPAT). Meanwhile greater leverage will counterbalance margin attrition and ensure RoE is kept at an attractive level above 20% in FY2009.

Solid financial performance

Argonaut has been impressed by TOX's recent performance, as well as its operations and management (Argonaut has visited both the Company's head office, and the Kwinana and Henderson sites recently). Growth opportunities are available, while its diversified services and broad geographic reach provide a defensive quality.

Valuation & Recommendation

TOX's closest listed competitor is Trans Pacific Industries (TPI). Others in the industry include Pacific Environment (PEH), Stericorp (STP), Hydromet (HMC), Anaeco (ANQ), Phoslock Water Solutions (PHK), Environmental Clean Technologies (ESI) and The Environmental Group (EGL), all of which are micro caps.

Argonaut sees considerable growth potential for the group as it cross-sells its services across Australia, and suggests a P/E premium is warranted when compared to the lower growth potential TPI (consensus forward P/E of 7.5x) and the S&P/ASX Small Ords (forward P/E of 9.4x). However, the current environment provides unrealistic comparative multiples on which to value stocks and Argonaut's preferred valuation methodology is based on a DCF calculation.

..... and a valuation of \$2.07 per share warrants a Buy recommendation

This method provides a valuation of \$2.07 per share, based on a WACC of 11.2%. It implies a 13.7x P/E ratio, which in Argonaut's view recognises TOX's high margins, defensive qualities and growth potential. This is comfortably ahead of the current share price and Argonaut initiates coverage of TOX with a Buy recommendation.

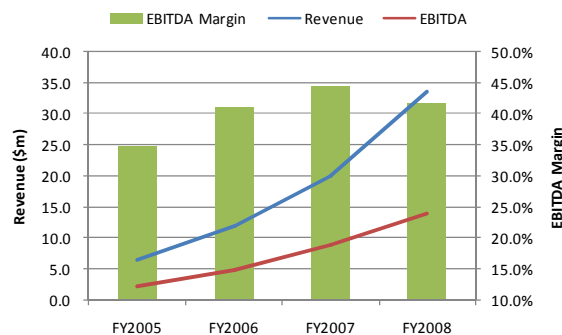
Background

TOX has expanded its business lines

TOX was floated in September 2000 on the back of its thermal desorption technology in Kwinana. Attempts to commercialise this business were unsuccessful as earnings, determined by property development, tended to be very lumpy. The waste management business operating in Port Hedland subsidised the business over this period, and the Company performed poorly until the end of 2004.

A major restructuring took place at this time, new capital was raised and TOX entered the liquid waste market by establishing a plant at the Kwinana site. The Company has recovered strongly since then, broadening its services and locations, and exhibiting strong earnings growth at attractive margins. Managing Director Steve Gostlow, along with General Manager Ged Styles, were instrumental in the financial and operational turnaround.

Figure 1: TOX Earnings Growth and Margins



Source: TOX, Argonaut

Business Overview

..... to become one of Australia's largest integrated waste management businesses

TOX is now one of the largest integrated waste management and environmental service businesses in Australia. The expansion of the business over the last few years means that the Company provides a wide array of services to a broad range of clients.

Table 1: Business Overview

Typical Services	Types of Waste Treated	Typical Customers
Contaminated site remediation	Oily and hydrocarbon based waste waters and sludge	Oil and Gas industry
Hazardous and industrial waste management	Inorganic and heavy metal liquid and solid wastes	Mining Industry
Alternative waste treatment technologies	Industrial and laboratory chemicals	Chemical Manufacturing and Processing Industry
Recycling and resource recovery	Pesticides, herbicides and fungicides	Industrial and Fabrication Workshops
Liquid waste collection services	Workshop waste including coolant, oily rags, spill sorbent materials, oil filters and grease	Laboratories including private, universities and schools
Integrated waste management systems	Contaminated soils	State and Local Government – Household Hazardous Waste Collection Centres
Waste and wastewater treatment, operations and maintenance		Automotive workshops
Industrial services such as industrial cleaning, tank degassing and vessel entry		Printing Industry
Thermal desorption and pyrolysis		Pharmaceutical Industry
Waste management consultation		Defence departments
		Ship building and port industry

Divisions

The group is broadly diversified

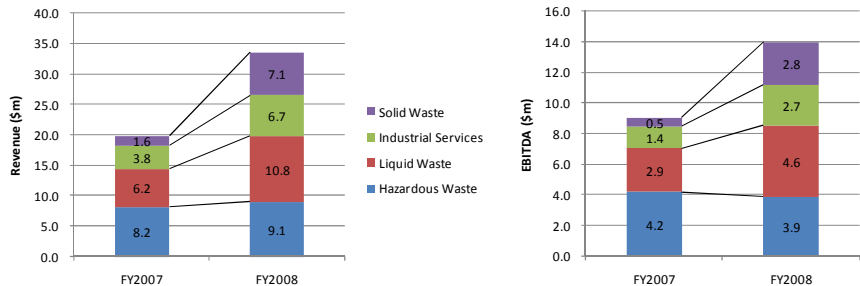
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TOX splits the business into 4 broad divisions:

- × Hazardous Waste
- × Liquid Waste
- × Industrial Services
- × Solid Waste

The latest numbers for FY2008 show that these divisions provide broad diversification benefits with each making meaningful contributions to revenue and profits.

Figure 2: TOX Divisional Contributions



Source: TOX, Argonaut

Unique Licenses & Specialised Services

..... with unique licenses providing barriers to entry

A significant portion of TOX's value lies in the licenses rather than the technology. The Kwinana plant for example, is the only licensed plant in Australia that is allowed to have contaminated soil brought to the plant (competitors elsewhere have to move their equipment to the contaminated area). As a result, soil from all around Australia is processed at the Kwinana plant.

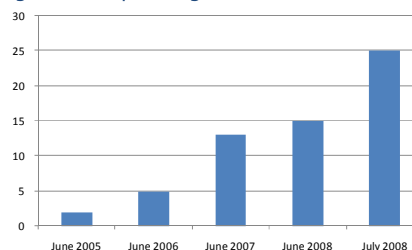
TOX operates the only dedicated industrial waste incinerator in Australia and has a very strong position in waste management in north-west WA (particularly in the Kimberley region). Again, TOX finds that toxic waste is being sent from all around Australia to be processed at Port Hedland. Upgrades to the incinerator have been delayed, but will allow for further growth once completed.

TOX is also well placed given the introduction of legislation covering the transportation of dangerous goods, which will require transporters to have an accredited Emergency Cleanup Service Provider.

An Expanding Footprint

Further diversification is obtained through an expanded geographic reach, with a dramatic growth in the number of sites over the last few years. The recent acquisition of Barry Brothers, effective 1 July 2008, now gives TOX an Australia-wide footprint.

Figure 3: Expanding Number of Locations



Source: TOX, Argonaut

Barry Brothers Acquisition

The acquisition of Barry Brothers

Barry Brothers is regarded as a market leader in the industrial services sector, with services including sewer cleaning, high pressure water cleaning, waste water recycling and reclamation, vacuum loading and waste management. The Company operates out of locations in Queensland, NSW, Victoria and South Australia.

Figure 4: Expanding Geographic Reach



Source: TOX

Filling the Gaps

Table 2: Expanding Geographic Reach

	Hazardous Waste	Liquid Waste	Industrial Services	Solid Waste
Western Australia:				
Wyndham / Kununurra		✓	✓	✓
Derby		✓	✓	✓
Broome		✓	✓	✓
Port Hedland	✓	✓	✓	
Karratha	✓	✓	✓	✓
Coral Bay				✓
Carnarvon				✓
Henderson			✓	
Kwinana	✓	✓		✓
Kalgoorlie		✓	✓	✓
Queensland:				
Rockhampton		✓	✓	
Brisbane / Gold Coast			✓	
New South Wales:				
Gosford			✓	
Sydney	✓		✓	
Victoria:				
Albury / Wodonga			✓	
Mulgrave			✓	
Mt Waverley			✓	
Altona			✓	
South Australia:				
Adelaide			✓	

Source: Argonaut, TOX

..... provides significant opportunities for cross selling

East Coast Expansion an Opportunity & a Challenge

FY2008 saw a solid financial performance

TOX had a solid FY08, with overall revenue climbing 67% to \$33.6m (10% ahead of the Company's original forecast). EBITDA climbed 56%, of which 25% was organic. Over the last year TOX saw acquisitions, the development of facilities in Sydney and Karratha, and increased market penetration and diversification. The addition of Barry Brothers to the mix now provides a national platform for growth.

The purchase price for Barry Brothers was \$25m based on an acquisition multiple of 3x EBITDA and has been financed by debt. Goodwill was a relatively small component with plant and equipment valued at more than \$20m (including 108 specialty vehicles with a replacement value of \$35m).

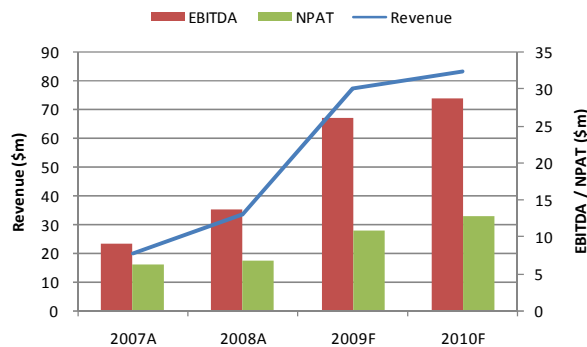
TOX expects immediate margin improvement for Barry Brothers through synergies, as well as the opportunity to cross sell and expand industrial services and, ultimately, a hazardous waste treatment network Australia-wide.

This provides TOX with a huge opportunity but also poses challenges, the biggest being the integration of two similar sized businesses on opposite sides of the country. Also gearing (net debt/equity) climbed significantly from 51% to 126% post the purchase on 1 July, and Barry Brothers will erode TOX's spectacular margins. Having said that, debt is still at comfortable levels (Argonaut expects interest cover above 5x in FY2009) and despite the fall in EBITDA margin from 41.5% in FY2008, this year should still be very healthy at 33.6%.

..... which is set to continue in FY2009

Argonaut's forecasts anticipate a more than doubling in revenue in FY2009, with around 82% of the increase accounted for through the Barry Brothers acquisition. Factoring in the lower margins at Barry Brothers together with a higher amortisation charge results in a forecast 91% increase in EBITDA and 60% increase in NPAT in FY2009.

Figure 5: Forecast Revenue and Profits



Source: Argonaut

..... providing attractive returns on equity and assets

The increased leverage in FY2009 more than compensates for the increased interest charge and lower margins, with RoE expected to climb this year from 18.9% to an expected 24.5%.

Figure 6: Forecast Returns on Assets and Equity



Source: Argonaut

Directors

TOX is led by an able and experienced team that has steered a significant turnaround in fortunes over the last few years

Table 3: TOX Directors

<p>DOUGLAS WOOD Chairman</p>	<p>Mr. Wood is a Chartered Accountant and a Fellow of the Taxation Institute of Australia. He has over 40 years' experience in the accounting and taxation profession and has been actively involved in the management of a number of public companies for many years, fulfilling the roles of Chairman and Managing Director</p>
<p>MICHAEL HUMPHRIS Director, non-executive</p>	<p>Michael Humphris is a Chartered Accountant with over thirty years' experience in the areas of business advice, corporate recovery and dispute resolution. He has extensive experience in business reconstructions, enhancing value for shareholders, divestments, mergers and acquisitions. He has been a director since 1998 and is a member of the Audit Committee.</p>
<p>STEPHEN GOSTLOW Managing Director</p>	<p>Stephen Gostlow is a qualified Environmental Scientist with a background specifically focusing on Waste Management, Health Safety and Environmental (HSE) Compliance, Dangerous Goods and Hazardous Waste handling and treatment.</p> <p>He initially gained waste management experience in the mining sector, before joining the State Government, Environmental Protection Authority (EPA). He completed 4 years with the EPA in the licensing and waste management sections gaining valuable experience in regulatory compliance before joining Tox Free as Compliance Manager in April 2002. He was appointed North West Regional Manager in December 2002 and State Manager in December 2003. He is responsible for overseeing all operations and has been a director since 2005.</p>
<p>RICHARD ALLEN Executive Director</p>	<p>Richard Allen is a Civil Engineer who has worked as a design and supervising engineer on road, bridge and structural projects in Australia, UK and the Middle East before joining Baroid, a Houston, Texas based petroleum service-company in May 1978. With Baroid, he filled a variety of technical and management positions culminating in the position of Manager for the Asia/Pacific Region.</p> <p>Since January 1999 he has been directly involved in the environmental service industry with specific focus on waste to energy and renewable energy projects and brings this specific expertise to Tox Free. He has been a director since 2005.</p>
<p>WYNN REES Director, non-executive</p>	<p>Wynn Rees is a veteran of the waste management industry in WA. He brings to Tox Free over 30 years of experience in establishing successful businesses throughout WA. Wynn was the owner of Kimberley Waste Services until 1 April 2007 when Tox Free acquired the business. Wynn founded Kimberley Waste in 1989, which has grown to be the leading waste management company in the Kimberley and Gascoyne regions of WA. He has been a director since April 2007.</p>
<p>GERRARD STYLES Executive Director</p>	<p>Ged is a qualified Petroleum Geologist who has worked as both a drilling engineer and well test specialist in the North Sea and Africa on numerous oil and gas projects.</p> <p>Over the past 15 years, Ged has held various management and board positions in a number of Industrial Services, Hazardous and Liquid Waste Management Companies. Ged holds an MBA and has been involved with both start-ups and established organisations in the UK and Australia. Ged has been involved with Tox Free since 2001 and has been a significant part of the turnaround and growth since 2005.</p>

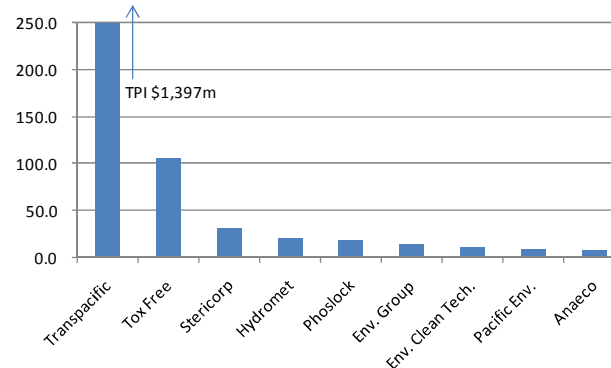
Source: TOX

Valuation & Recommendation

The group has few comparable peers

TOX's closest listed competitor is Trans Pacific Industries (TPI), which has a market cap 13x that of TOX. Others in the industry include Pacific Environment (PEH), Stericorp (STP), Hydromet (HMC), Anaeco (ANQ), Phoslock Water Solutions (PHK), Environmental Clean Technologies (ESI) and The Environmental Group (EGL), but these are all a fraction of the size of TOX. The main unlisted competitor is Veolia.

Figure 7: Comparative Market Capitalisations (\$m)



Source: IRESS

..... but a premium is warranted given the strong growth profile

This makes it difficult to value TOX on comparative multiples. In addition Argonaut sees considerable growth potential for the group as it cross-sells its services across Australia, suggesting a P/E premium is warranted when compared to the lower growth potential TPI (consensus forward P/E of 7.5x) and the S&P/ASX Small Ords (forward P/E of 9.4x). Also, the current environment provides unrealistic comparative multiples on which to value stocks. Argonaut's preferred valuation methodology is therefore based on a DCF calculation.

Argonaut's DCF valuation is \$2.07 per share prompting a Buy recommendation

This method provides a valuation of \$2.07 per share, based on a WACC of 11.2%. It implies a 13.7x P/E ratio, which in Argonaut's view recognises TOX's high margins, defensive qualities and growth potential. This is comfortably ahead of the current share price and Argonaut initiates coverage of TOX with a Buy recommendation.

Tox Free Solutions Limited
Equities Research
 Ian Christie, CFA

Recommendation	BUY
Current Price (\$)	1.54
All Ords (XAO)	4,346.1

Sector	Equip. & Services
Market Cap (\$m)	105.7
Date	14 October 2008

Profit and Loss (\$m)	2007A	2008A	2009F	2010F
Revenue	20.1	33.8	77.3	83.6
EBITDA	8.9	13.6	26.0	28.6
Depreciation	-1.6	-2.8	-7.0	-7.1
EBIT	7.3	10.8	19.1	21.5
Interest	-0.4	-1.4	-3.7	-3.3
PBT	6.9	9.4	15.4	18.3
Normalised NPAT	6.2	6.7	10.8	12.8

Cash Flow (\$m)	2007A	2008A	2009F	2010F
Receipts	17.4	30.2	66.8	81.8
Payments	-9.7	-19.2	-46.1	-54.4
Other	-0.3	-4.1	-5.5	-7.6
Cash from Operations	7.4	6.8	15.2	19.9
Property, Plant & Equip	-9.4	-8.3	-8.8	-7.0
Payment for Subsidiary	-15.1	-6.8	-27.4	-0.4
Other	-0.4	0.0	0.0	0.0
Cash From Investing	-24.8	-15.1	-36.2	-7.4
Issue of Shares	4.5	0.3	0.0	1.4
Net Borrowing	11.5	6.7	24.9	-5.1
Dividends	0.0	0.0	0.0	0.0
Cash From Financing	16.0	7.0	24.9	-3.7
Net Cash Flow	-1.5	-1.3	3.9	8.8
Ending Cash	2.9	1.6	5.5	14.3

Balance Sheet (\$m)	2007A	2008A	2009F	2010F
Cash	2.9	1.6	5.5	14.3
Receivables	5.0	8.6	19.0	20.5
Inventory	0.1	0.1	0.4	0.5
Other	0.2	0.4	0.4	0.4
Current Assets	8.2	10.6	25.3	35.7
Property, Plant & Equip	15.3	23.4	49.5	49.4
Intangibles	17.2	23.3	26.4	26.8
Other Non-current Assets	0.4	0.2	0.2	0.2
Non-Current Assets	32.9	46.9	76.1	76.4
Total Assets	41.1	57.5	101.4	112.1
Payables	3.4	3.6	9.1	9.8
Borrowings	11.6	18.5	43.4	38.3
Provisions	0.3	0.4	0.4	0.4
Other	1.4	1.9	4.6	5.5
Total Liabilities	16.6	24.4	57.6	54.1
Net Assets	24.5	33.1	43.8	58.0
Ordinary Equity	27.4	29.3	29.3	30.7
Reserves	0.2	0.6	0.6	0.6
Retained Earnings	-3.1	3.2	13.9	26.7
Total Equity	24.5	33.1	43.8	58.0

Summary	
Valuation (A\$ per share, diluted)	2.07
Forecast 2009 Yield (%)	0.0%
Forecast 2009 P/E (x)	10.2

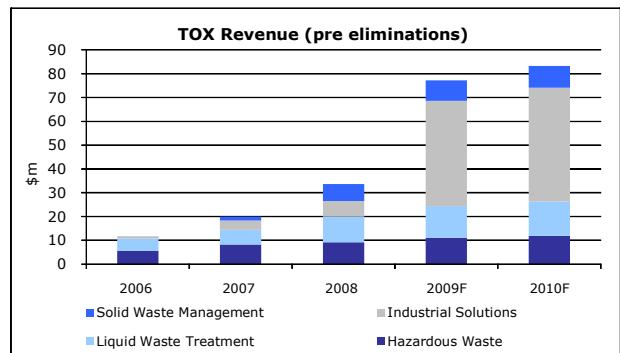
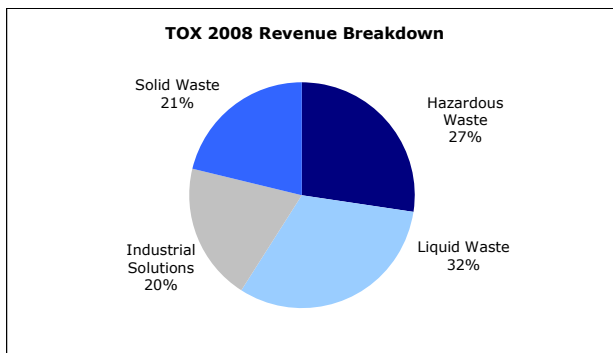
Valuation Method	Calculations	Results
DCF Valuation	Discount Rate / WACC (%)	11.2%
	PV Free Cash Flow (\$m)	162.7
	Less Net Debt / Plus Cash (\$m)	-16.9
	Unpaid Capital (\$m)	1.3
	Equity Value (\$m)	147.1
Equity Value (A\$ps)		2.07

	Multiple	EV	Equity Val	per Share
EV/EBITDA (x)				
EV/EBIT (x)				
P/E (x)				
Multiple Valuation (A\$ps)				

Valuation	2.07
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Financial Ratios	2007A	2008A	2009F	2010F
Balance Sheet Ratios				
Net Debt / Equity (%)	35.6%	51.0%	86.4%	41.3%
Current Ratio (x)	1.7	1.4	1.4	1.8
Net Interest Cover (x)	22.0	8.6	5.3	7.3
Profitability Ratios				
Gross Margin (%)	45.0%	41.5%	33.6%	34.0%
Net Profit Margin (%)	31.1%	19.9%	13.9%	15.4%
Return on Assets (%)	19.1%	19.3%	19.9%	22.0%
Return on Equity (%)	24.8%	18.9%	24.5%	22.1%
Cash Flow Ratios				
Free Cash Flow Yield	7.9%	-7.8%	-16.1%	14.4%

Per Share Data	2007A	2008A	2009F	2010F
Basic EPS (cps)	9.4	9.9	15.4	18.2
Diluted EPS (cps)	9.0	9.4	15.1	18.0
Diluted P/E (x)	16.0	16.3	10.2	8.6
Dividends per share (cps)	0.0	0.0	0.0	0.0
Dividend Yield (%)				
NTA per share (cps)	10.6	14.0	25.0	43.9
Cash Flow per share (cps)	11.1	10.0	21.8	28.2



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