Stock Focus

Tox Free Solutions (TOX)

EVANS & PARTNERS

ONLY THE BEGINNING

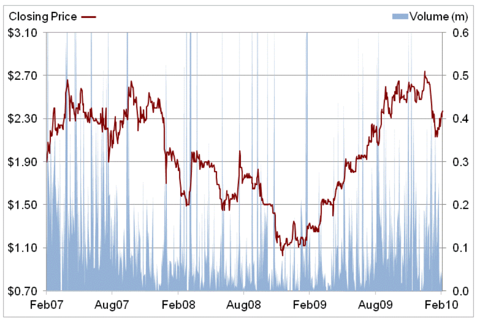
RECOMMENDATION : POSITIVE

Trading Data	
Last Price	$2.37
12 month range	$1.25 - $2.74
Market cap.	$214m
Free Float	$190m (94%)
Avg. daily volume	0.1m
Avg. daily value	$0.3m
12m return (historical)	85.2%

Earnings Forecasts

Yr to June	09A	10E	11E	12E
EBITDA ($m)	21	28	37	41
Rep NPAT ($m)	8	12	18	21
Adj NPAT ($m)	8	12	18	21
EPS (¢)	9.9	13.4	18.4	21.9
EPS Gth (%)	20.3	35.7	37.2	19.2
PER (x)	**24.0**	**17.7**	**12.9**	**10.8**
PEG Ratio (x)	0.3	0.3	0.4	
DPS (¢)	0.0	1.0	2.0	3.0
Yield (%)	**0.0**	**0.4**	**0.8**	**1.3**
Franking (%)	0%	100%	100%	100%
ROE (%)	**14%**	**13%**	**16%**	**16%**
EV/EBITDA (x)	**11.5**	**8.0**	**5.8**	**4.6**
NetDebt/EBITDA (x)	1.5	0.3	(0.1)	(0.6)
Int. Cover (x)	3.9	10.9	27.0	(243.8)
Valuation (blended)				**$2.79**

Share Price History



VIEW

Solid result in tough conditions an **important milestone** in TOX's journey to become a high quality mid-cap industrial company.

Extremely positive outlook reflects the benefit of major contract wins yet to contribute to earnings, increasing scope for scale-driven cost efficiencies, growing reputation as a quality integrated industrial services & waste management provider and dominant position in North West WA.

We **retain our Positive view** based on:

- **Strategic assets** exposed to high growth industries (LNG, iron ore);
- **Strong pipeline** of opportunities (four large contracts pending);
- **Strong balance sheet** (net debt down to $8m) providing firepower to bid for major contracts & **acquisitions**; and
- **Valuation support** (~13x FY11 PER).

RESULT

Key points from a very credible 1H10 result amidst tough conditions:

- **Revenue +13%** (market share gains/contract wins) & **EBITDA +15%** (operating leverage/initial efficiencies offset +$2m overhead).
- **EPS** +28% and **quality high** (30% tax rate, 89% cash conversion, increasing proportion of revenue under contract).

FORECASTS & VALUATION

- EBITDA margins & forecasts upgraded by 2-4% but **EPS forecasts cut 1-3%** due to higher depreciation charge.
- We do not assume any **additional contract wins** in our base case forecasts but expect further announcements over the next 3 months.
- Our **blended valuation rises 3% to $2.79**.

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February 26, 2010
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1H10 RESULT

- **Revenue** +12.5% to $47m driven by market share gains, contract wins & Tox's dominant position in NW WA.
- **EBITDA** was bang in line with our expectations, up 15% to $11.5m. Margins expanded by 54bps to 24.6% despite significant investment in corporate overheads (+82% to $4m) to support future growth.
- **Divisional EBIT** performance:

TOX-FREE: DIVISIONAL PERFORMANCE

6 months to Dec Division	2008A $m	2009A $m	Change (%/bp)	Comment
Hazardous Waste	5.4	6.7	25%	Increased volumes at all facilities
Liquid Waste	6.0	5.1	(15%)	Lower manufacturing sector volumes in Perth & Brisbane
Industrial Services	25.5	27.4	7%	Strong growth in the Pilbara; East Coast "performing well".
Solid Waste	4.6	7.5	64%	Initial volumes from the Woodside & Gorgon contracts
Group Sales	**41.5**	**46.7**	**13%**	**Winning market share in a tough operating environment**
Hazardous Waste	1.9	3.1	57%	Brisbane facility expanded services into Surat/Bowen basins
Liquid Waste	2.1	1.9	(8%)	Solid cost control
Industrial Services	3.3	3.9	18%	Deliberate mix shift to higher margin services
Solid Waste	0.9	2.4	162%	High capacity utilisation
Corporate	(2.3)	(4.2)	82%	Investment in capability to handle significant growth
Group EBIT	**6.0**	**7.1**	**20%**	
Hazardous Waste	36.2%	45.6%	945	Margin commensurate with quasi-monopoly assets
Liquid Waste	34.7%	37.5%	273	Upside as volumes recover
Industrial Services	12.8%	14.1%	130	Mix shift, Pilbara ramp up, initial cost efficiency benefits
Solid Waste	20.3%	32.6%	1221	Additional services provided at high margin
Group EBIT/Sales	**14.4%**	**15.3%**	**90**	**Up despite sharp increases in corporate costs, D&A**

Source: Company data, E&P Research

- Result **quality** good with **depreciation** +8% offset by **net interest** -31% (raised $25m equity); tax rate 30%.
- **NPAT** up 44% to $4.0m and **Diluted EPS** +28% to 4.9¢.
- **Cash conversion of 89%** (GOCF/EBITDA) was due entirely to working capital build. **Capex** trebled to $6m and likely to double again in 2H10 to support Gorgon/RIO contract wins. **Balance sheet** strong after last year's equity raising with net debt at $8m, helping provide firepower to bid for major contracts and make acquisitions.

OUTLOOK

"The outlook for Tox Free is extremely positive. As economic activity increases it is expected volumes of waste from the manufacturing, mining and construction industries will also increase. This will have a positive effect on all divisions. Together with earnings contributions from the recently awarded contracts with Rio Tinto and Toll Energy (Gorgon LNG), Tox Free expect significant growth in earnings in both the second half of FY2010 and FY2011."

TOX is confident of achieving its previously stated **guidance** for FY10 EBITDA of $26-28m. We see the balance of **risks to the upside** but are **more focused on FY11-12** which **should see the benefit of**:

- **Gorgon/RIO contracts** fully ramped up = $12m+ incremental revenue at ~30% margin.
- Scale-driven **cost efficiencies** (mainly procurement) could deliver >$1m to the bottom line.
- **Greater returns focus** - low yielding assets (*eg.* street sweepers) sold, capital redeployed at higher margins;
- **Mix shift of Industrial Services work** from volatile civil construction sector towards longer term contracts with mining & manufacturing clients should improve utilisation & fixed cost recovery rates.

All of which could yet be dwarfed if Tox is awarded the four large waste management & industrial services **contracts still pending**, or is able to identify and execute **acquisitions** to address remaining gaps in its footprint.

EARNINGS FORECASTS & VALUATION

Adjustments to our **EPS forecasts** as set out below reflect:

- Recent Industrial Services contract wins offsetting softer Liquid Waste volumes in Perth/Brisbane;
- Solid operating leverage and cost control driving higher EBITDA margins across all divisions; offset by
- Higher depreciation charge as mobile equipment to support major contract wins is written down over 5 years.

Metric	Sales ($m)			EBITDA ($m)			EPS (¢)			DPS (¢)		
Yr to June	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2009A	88	88	0%	21.4	21.4	0%	9.9	**9.9**	**0%**	0.0	0.0	N/A
2010E	106	105	(2%)	27.5	28.0	2%	13.8	**13.4**	**(3%)**	1.0	1.0	0%
2011E	127	127	(0%)	35.5	36.8	4%	18.6	**18.4**	**(1%)**	2.0	2.0	0%
2012E	140	139	(0%)	39.4	41.1	4%	22.1	**21.9**	**(1%)**	3.0	3.0	0%
Blended Valuation				**$2.70**	**$2.79**	**3%**						

Source: Company data, Evans & Partners Research estimates

Our **blended valuation** rises 3% to $2.78 on the back of operating earnings upgrades & roll-over of our PE Relative valuation to FY11 when TOX's earnings will reap the full benefit of the Gorgon & RIO contracts as well as cost efficiencies:

TOX-FREE SOLUTIONS VALUATION SUMMARY							
Capitalisation of Earnings	EBITDA ($m)			EV/EBITDA (x)			EV ($m)
Year to 30 June	**2009A**	**2010E**	**2011E**	**2009A**	**2010E**	**2011E**	**2010E**
Hazardous/Liquid Waste	9.1	11.1	11.9	10.9	9.0	8.4	99
Solid Waste	2.2	4.4	4.8	17.5	9.0	8.2	39
Industrial Services	10.7	13.1	15.4	8.0	6.5	5.5	85
Gorgon/RIO	0.0	1.5	6.9	n/a	43.6	9.5	65
Corporate	(0.6)	(2.0)	(2.2)	23.7	7.5	7.0	(15)
Group	**21.4**	**28.0**	**36.8**	**12.8**	**9.8**	**7.5**	**274**
Net Debt/(Cash) post Options							(1)
Market Cap							275
Shares on Issue incl Options (m)							96
Valuation ($ps)							**$2.87**
PE Relative - FY11E							
Small Industrials (x)							10.8
TOX Premium/(Discount)							40%
Target PER (x)							15.1
Valuation ($ps)							**$2.78**
Discounted Cash Flow ($ps)	11.5% WACC						**$2.72**
GROUP BLENDED VALUATION ($ps)							**$2.79**

Source: Evans & Partners Research estimates

We apply a 40% premium to the Small Industrials market FY11 PER to reflect TOX's:

- **Strategic assets** exposed to high growth industries/geographies (*eg.* oil & gas/iron ore in North West WA);
- **Strong pipeline** of opportunities (four contract decisions are pending that could have a material impact); and
- **Strong balance sheet** (net debt down to $8m).

FINANCIAL SUMMARY

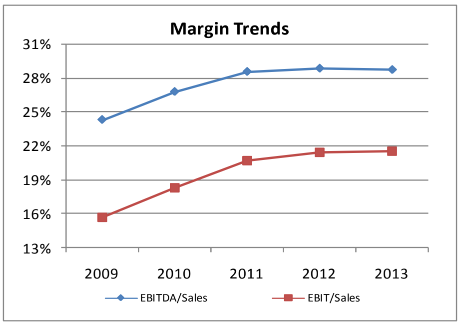
Tox Free Solutions	**TOX**		
As at:	**26/02/2010**	**Recommendation: Positive**	**Share Price $2.37**

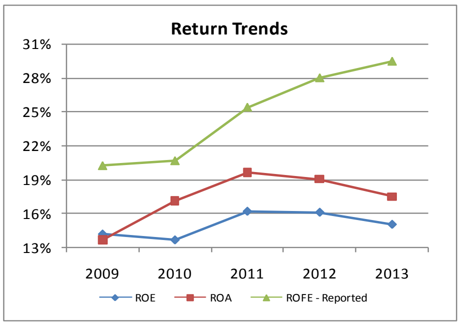
Year end	June	2009A	2010E	2011E	2012E
INCOME STATEMENT					
Sales Revenue	**$m**	**88**	**105**	**127**	**139**
Consolidated EBITDA	$m	21	28	37	41
D&A	$m	(8)	(9)	(11)	(11)
Consolidated EBIT	**$m**	**14**	**19**	**26**	**30**
Net Interest	$m	(4)	(2)	(1)	0
Tax Expense	$m	(3)	(5)	(8)	(9)
Associates/Minorities	$m	0	0	0	0
Adj NPAT	**$m**	**8**	**12**	**18**	**21**
NRIs	$m				
Reported NPAT	$m	8	12	18	21
Shares on Issue (end period)	m	79	91	93	94
EFPOWA	m	77	90	96	96
EPS	**¢**	**9.9**	**13.4**	**18.4**	**21.9**
DPS	¢	0.0	1.0	2.0	3.0
Franking	%	0%	100%	100%	100%
GROWTH/PROFITABILITY RATIOS					
Sales Growth	%	162.1%	18.8%	20.9%	9.9%
EBITDA Growth	%	65.9%	31.0%	31.3%	11.7%
EBIT Growth	%	37.3%	36.4%	38.7%	14.3%
EPS Growth	**%**	**20.3%**	**35.7%**	**37.2%**	**19.2%**
EBITDA/Sales	%	24.3%	26.8%	29.1%	29.5%
EBIT/Sales	%	15.7%	18.0%	20.7%	21.5%
EBIT Interest Cover	x	3.9	10.9	27.0	(243.8)
Tax Rate	%	26.0%	30.0%	30.0%	30.0%
ROE	**%**	**14.2%**	**13.4%**	**16.4%**	**16.3%**
ROFE	**%**	**20.2%**	**20.4%**	**25.7%**	**28.4%**
CASH FLOW					
EBITDA	$m	21	28	37	41
Change in Working Capital	$m	(9)	(3)	(3)	(1)
Other	$m	7	0	0	0
Gross Operating Cash Flow	**$m**	**19**	**25**	**34**	**40**
Net Interest Paid	$m	(4)	(2)	(1)	0
Tax Paid	$m	(5)	(5)	(8)	(9)
Net Operating Cash Flow	**$m**	**10**	**18**	**25**	**31**
Maintenance Capex	$m	(10)	(9)	(12)	(12)
Free Cash Flow	**$m**	**0**	**9**	**13**	**19**
Dividends Paid	$m	0	0	(2)	(2)
Expansionary Capex	$m	0	(11)	(2)	0
Acquisitions	$m	(10)	0	0	0
Asset Sales	$m	0	2	0	0
Dividends Received	$m	0	0	0	0
Shares Issues/Buybacks	$m	13	24	2	4
Other	$m	0	(1)	0	0
Increase in Net Cash/(Debt)	**$m**	**2**	**23**	**12**	**21**
GOCF/EBITDA	%	87%	88%	92%	97%
Total Capex/Sales	%	(11.0%)	(18.4%)	(11.0%)	(8.7%)
Total Capex/Depreciation	x	1.3	2.1	1.3	1.1

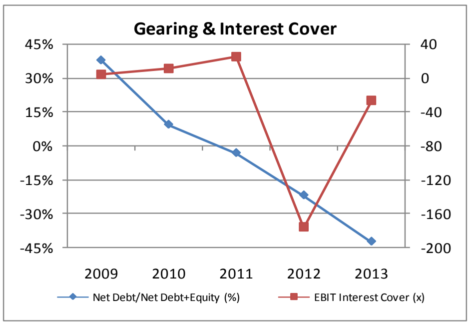
Year end	June	2009A	2010E	2011E	2012E
VALUATION METRICS					
PER	x	24.0	17.7	12.9	10.8
P/EG (2YR)	x	0.3	0.3	0.4	
Dividend Yield	%	0.0%	0.4%	0.8%	1.3%
EV/EBITDA	x	11.5	8.0	5.8	4.6
EV/EBIT	x	17.9	11.8	8.1	6.4
P/FCF	x	2,461.6	24.0	16.1	11.3
P/BV	x	3.5	2.6	2.1	1.8
BALANCE SHEET					
Assets					
Cash	$m	5	5	16	37
Working Capital	$m	22	24	28	30
PP&E	$m				
Intangibles	$m	0	0	0	0
Investments	$m	0	0	0	0
Other	$m	3	3	3	3
Total Assets	**$m**	**101**	**111**	**131**	**154**
Liabilities					
Debt	$m	37	14	14	14
Working Capital	$m	10	8	9	11
Other	$m	0	0	0	0
Total Liabilities	**$m**	**47**	**22**	**23**	**25**
Equity	**$m**	**54**	**89**	**107**	**129**
Capital Employed	**$m**	**87**	**99**	**105**	**106**
Net Debt/(Cash)	$m	33	9	(2)	(23)
Net Debt/Equity	%	61.1%	10.5%	(2.3%)	(17.9%)
Net Debt/Debt+Equity	**%**	**37.9%**	**9.5%**	**(2.3)%**	**(21.8)%**
Net Debt/EBITDA	x	**1.5**	0.3	(0.1)	(0.6)
Working Capital/Sales	%	13.9%	14.8%	14.6%	13.4%

DCF VALUATION			**$m**	**$/share**
Risk Free Rate	6.5%	Equity Value	238	$3.01
Market Risk Premium	6.0%	(Net Debt)/Cash	1	$0.01
Beta	1.30	Franking Credits		$0.23
WACC	**11.5%**	**DCF Valuation**		**$2.72**

DIVISIONAL SUMMARY					
Hazardous Waste	$m	11	13	14	14
Liquid Waste	$m	14	12	13	14
Industrial Services	$m	55	61	68	75
Solid Waste	$m	9	12	13	15
Gorgon/RIO	$m	0	6	18	21
Group Revenue	**$m**	**88**	**105**	**127**	**139**
Hazardous Waste	$m	4	5	6	6
Liquid Waste	$m	4	4	4	4
Industrial Services	$m	6	7	9	11
Solid Waste	$m	1	3	4	4
Gorgon/RIO	$m	0	2	5	6
Group EBIT	**$m**	**14**	**21**	**28**	**32**
Hazardous Waste	%	33%	42%	43%	43%
Liquid Waste	%	27%	30%	30%	32%
Industrial Services	%	10%	11%	14%	15%
Solid Waste	%	16%	28%	28%	29%
Gorgon/RIO	%		25%	30%	30%
Group EBIT/Sales	**%**	**16%**	**20%**	**22%**	**23%**







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RESEARCH RECOMMENDATION DEFINITIONS

Positive	Stock is expected to outperform the S&P/ASX 200 over the coming 24 months
Neutral	Stock expected to perform in line with the S&P/ASX 200 over the coming 24 months
Negative	Stock is expected to underperform the S&P/ASX 200 over the coming 24 months
Speculative	Stock has limited history from which to derive a fundamental investment view or its prospects are highly dependent on event risk, *eg.* Successful exploration, scientific breakthrough, high commodity prices, regulatory change, etc.
Suspended	Stock is temporarily suspended due to compliance with applicable regulatory and/or Evans & Partners policies in circumstances where Evans & Partners is acting in an advisory capacity.
Not Rated	Stock is not included in our investment research universe.

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Valuation	Rolling 12 month prospective multiples (composite of Price-to-Earnings Ratio, Dividend Yield and EV/EBITDA), or long-term NPV for resource stocks.
Earnings Outlook	Forecast 2 year EPS growth.
Earnings Momentum	Percentage change in the current consensus EPS estimate for the stock (rolling 1 year forward basis) over the consensus EPS estimate for the stock 3 months ago.
Shareholder Returns	Composite of forecast ROE (rolling 1 year forward basis) and the percentage change in ROE over 2 years.
Debt Servicing Capacity	Rolling 12 month EBIT Interest Cover ratio.
Cyclical Risk	Qualitative assessment of the 2 year outlook for a stock/industry's profit cycle.
Industry Quality	Qualitative assessment of an industry's growth/returns potential and company specific management capability.
Financial Transparency	If we don't understand it, we won't recommend it.

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