

Overview

TOL Gases Limited, formerly known as Tanzania Oxygen Limited, is the leading producer and distributor of industrial and medical gases in Tanzania.

The company was established in 1950 and is publicly listed on the Dar es Salaam Stock Exchange (DSE). Over the years, it has evolved from its original ownership by African Oxygen and Acetylene Company (AFROX) into a locally-owned entity, with 89% of its shares now held by Tanzanians.

Products and services

TOL's products include:

- Industrial gases
- Medical gases
- Inert gases
- High purity gases
- Medical consumables
- Welding solutions

The company also sells gas-related equipment and provides technical services such as installation, maintenance, and training related to the safe handling and use of gases and related equipment.

Target industries

The company sells its products and services to a wide range of customers in the following industries;

- Food and beverage
- Healthcare
- Chemicals
- Glass and minerals
- Manufacturing
- Energy
- Water and Waste
- Construction
- Paints and coatings

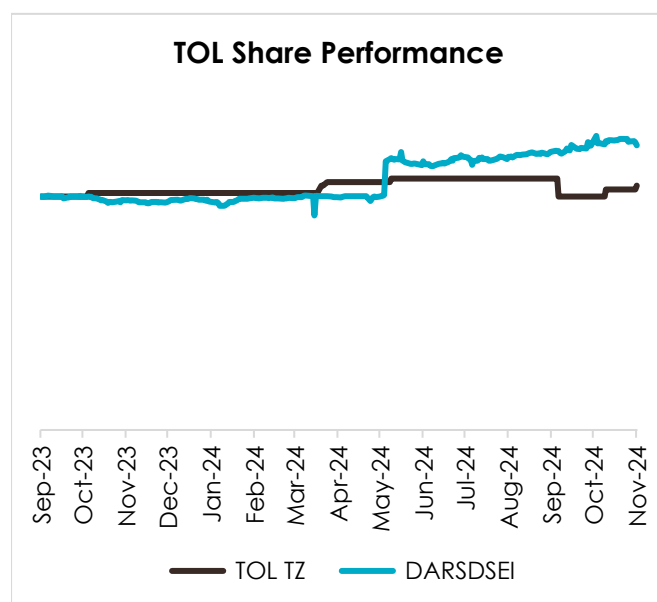
Distribution

TOL Gases has three plants located in Dar es Salaam, Mwanza and Mbeya, and one outlet shop in Arusha. Additionally, it has a diversified geographical reach consisting of six countries i.e., Kenya, DRC, Zambia, Malawi, Zimbabwe and Mozambique.

The company's daily production capacity includes 64 tons of CO₂ per hour, 1,560 M³ of acetylene, and 31 tons of ASU gases, with operations spread across three plants located in Mbeya, Mwanza, and Dar es Salaam.

Share Data

Industry	Basic & diversified chemicals
Recommendation	HOLD
Current Price (KES) –19/11/24	680.00
Target Price (KES)	710.53
Upside/(Downside)	4.5%
52WK High (KES)	770.00
52WK Low (KES)	650.00
Market Cap (TZs Bn)	57.5
Free float	36.10%



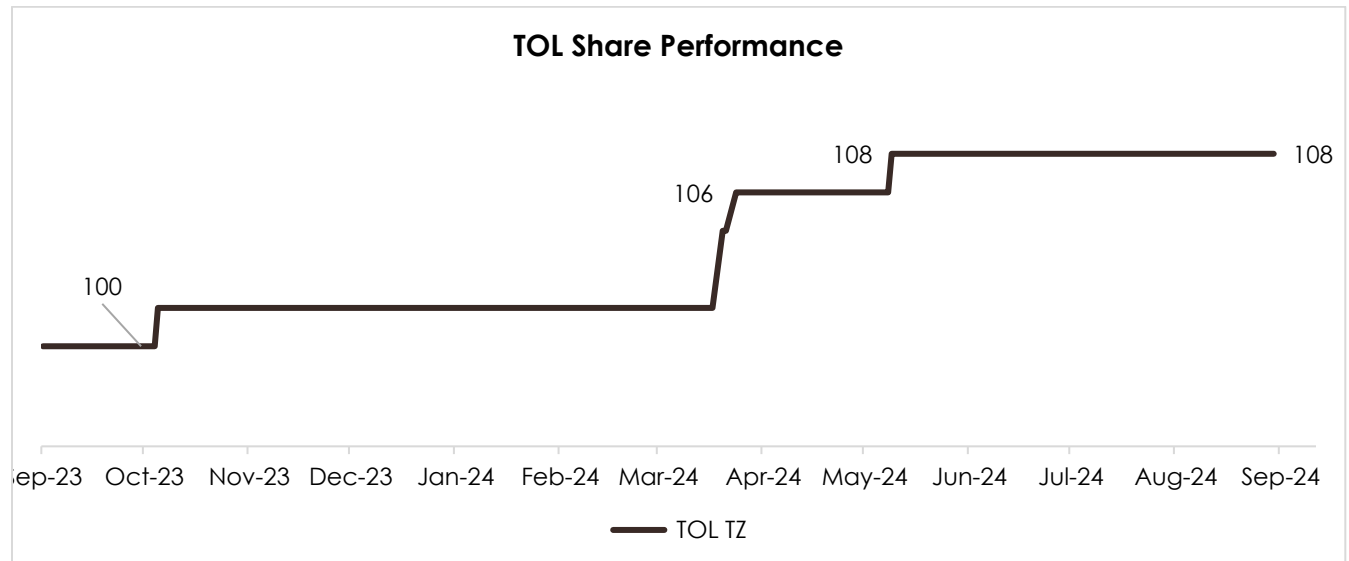
Analyst

Anjali Patel – Anjali.patel@ncbagroup.com

Management was unavailable for comment or to address questions during the preparation of this report

Stock Performance

Negligible dividend payouts have impacted investor sentiment on the Exchange. As a result, the stock has been illiquid. Full liberalization of foreign investment on the DSE in 2014 led to a significant price increase from TZS 310 to a peak of TZS 855. A dividend yield of 7% in 2022 boosted the share price by 23% year to date.



From our valuation, the company presents a promising growth prospect. It's current market price nevertheless appears overvalued, trading at a P/E ratio of 11.47x, significantly higher than the industry average of 8.4x.

Business segments

- **Oxygen** - High-quality oxygen is essential for efficient gas cutting, ensuring swift, clean cuts. Oxygen finds diverse applications in metal manufacturing, chemicals, pharmaceuticals, petroleum, glass, ceramics, pulp and paper, environmental processes, and various miscellaneous uses.
- **Nitrogen** is a key component in the chemical industry. It is used to make fertilizers, nitric acid, nylon, dyes and explosives.
- **Carbon dioxide** - Carbon dioxide is employed as a welding atmosphere, reacting within the welding arc to oxidize metals, thereby facilitating the welding process and promoting the oxidation of most metals.
- **Argon** - It is integral to industrial processes. Argon is utilized in arc welding methods like gas metal and tungsten arc welding, and in the processing of reactive elements such as titanium. It's also crucial for crystal growth in silicon and germanium.
- **Hydrogen** - Hydrogen is used in various industries including petroleum refining, chemical production, and as fuel for vehicles and power generation.

- **Acetylene** - Acetylene fuels welding and cutting processes, known as oxy-fuel or gas cutting, reaching temperatures of up to 3,500°C (6,330°F). It generates the hottest flame among gases, enabling precision cutting and welding of high-temperature materials.
- **Helium** - Helium gas inflates blimps, scientific balloons, and party balloons. It also serves as an inert shield in arc welding, pressurizes fuel tanks for liquid-fuelled rockets, and aids in supersonic wind tunnel operations.
- **Nitrous oxide** - Nitrous oxide finds diverse applications in medical anaesthesia, food processing, semiconductor manufacturing, analytical chemistry, and chemical production. Additionally, it's utilized in auto racing for engine injection, reflecting its versatility.
- **Ammonia** - Ammonia serves multiple purposes, including, rocket fuel, purification of drinking water as well as food processing. It removes stains and tarnish, combating soap build-up in tubs and sinks, and restores lustre to silver, brass, and gold jewellery.

Medical gases

- **Medical oxygen** - Foundational for modern aesthetic techniques, this method enhances tissue oxygenation, aiding conditions like Cyanosis, shock, haemorrhage, carbon monoxide poisoning, trauma, and cardiac/respiratory arrest, ensuring effective resuscitation and therapeutic intervention.
- **Medical air** - Medical air is vital for various patient applications, especially for those sensitive to oxygen toxicity. It offers a safe alternative, ensuring precise delivery of pure air for individuals with delicate respiratory systems or specific medical needs.

Other products

- **Dry ice** - It's used primarily for cooling purposes in industries like food preservation and shipping.
- **Gas welding & cutting** - Comprehensive product line features top-tier welding equipment, precision welding automation solutions, and authentic welding spare parts exclusively manufactured by ESAB - Elektriska Svetsnings-Aktiebolaget, Sweden.

Gases distribution

TOL Gases distribution channels encompass a network through which the company delivers its industrial and medical gases to customers. These channels include direct sales to end-users, partnerships with distributors, and online platforms for placing orders.

Top shareholding

Below are the top shareholders as of 30th March 2024.

Name	No. of shares	Shares held %
Ernest Saronga Massawe	9,613,462	16.72%
M/S Erncon Holdings Ltd	9,562,096	16.63%
Goodison 47 limited	6,818,080	11.86%

Treasury Registrar	3,550,457	6.21%
Anorld B.S Kilewo	3,264,144	5.88%
Godfrey Urasa	2,618,030	4.55%
Harold Temu	2,507,740	4.36%
Michael Shirima	1,680,405	2.92%
Public Service Social Security fund	1,083,333	1.88%
Joseph C.N Machinge	1,029,584	1.79%
	41,727,331	72.56%
Other shareholders	15,778,632	27.44%
TOTAL	57,505,963	100%

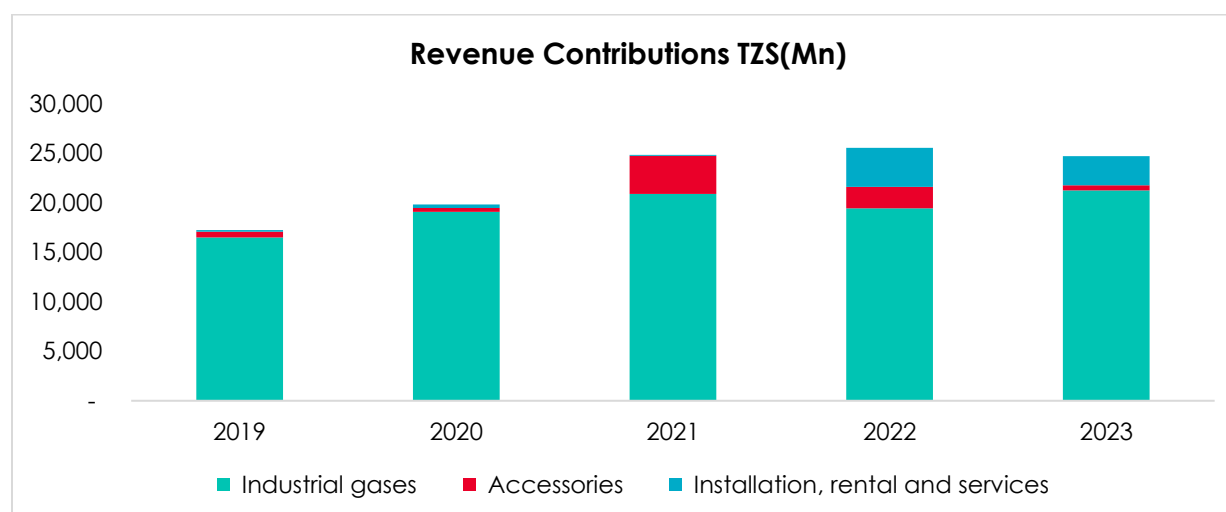
Key performance indicators

- **Sales revenues**

Historically, more than 85% of TOL's revenue has originated from the sale of industrial and medical gases with the balance coming from installation, rental, services and accessories.

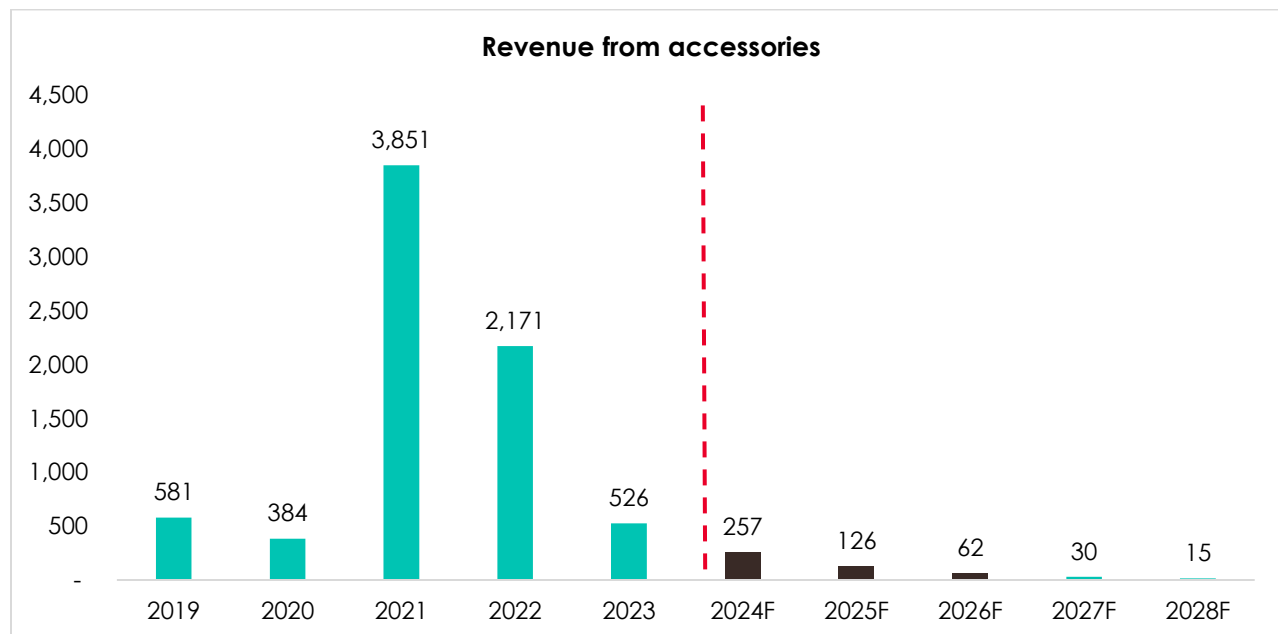
In 2023, sales revenue declined by 3% to TZS 24.7Bn from TZS 25.6Bn in 2022. The decline was attributed to a 76% and 25% drop in revenue generated from accessories and installation, rental & services respectively. There was a breakdown of the manufacturer's Ikama CO₂ plant towards the end 2023 which contributed to the significant decline in revenues for the year.

Sales revenue in 2022 increased by 3% to TZS 25.6Bn attributable to the government's project of supplying, installing, commissioning, and maintenance of Manifold systems for health facilities in Mainland Tanzania.



Revenues from accessories

Revenue from accessories, installation, and services experienced a significant surge, growing from TZS 715.17Mn in 2021 to TZS 3.49Bn in 2023, largely driven by government contracts for the supply of medical equipment and cylinders during the COVID-19 period. This growth is not sustainable post pandemic, as evidenced by a 92% decline in Q1 2024, with revenue dropping from TZS 3.19Bn in the same period in 2023 to TZS 249.35Mn

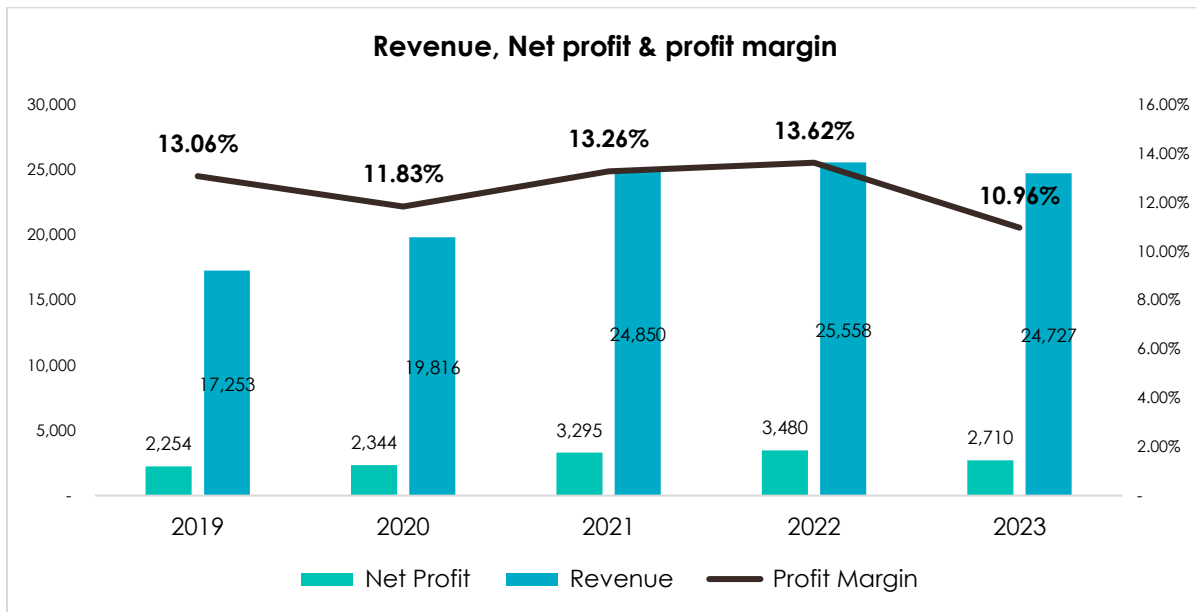


Source: Company Annual Reports, NCBA IB Research

The company has recorded modest revenue growth in the last five years notably in 2020 - 2021 (25.4%), driven by a resurgence in industrial activities post-pandemic. Tanzania's industrial activities experienced steady growth after the COVID-19 pandemic, propelled by government reforms and strategic investments. In 2023, the country's economy expanded to 5.1%, up from 4.7% in 2022.

We expect revenue from sale of industrial gases, equipment and facilities rental to grow by 6.84% and 6.78% respectively in 2024 driven by the installation of a new CO₂ production capacity and planned procurement of CO₂ additional road tankers and trucks. These portends for higher production volumes, to meet increased demand.

We are however cognizant of the impact of continued inflationary pressures, rising costs of power and fuel, which have a direct impact on the operating costs.



Source: Company Annual Reports, NCBA IB Research

The company has maintained an average net profit margin of 12.55%, which is indicative of efficient product pricing and cost management. Commissioning of new production facilities as well as recovery in demand for dissolved acetylene is expected to shore up profitability.

TOL's aggressive expansion strategy

By the close of 2023, TOL faced significant cash flow challenges, reporting a cash balance of TZS 6.8Mn—a staggering 99.87% drop from the TZS 5.10Bn held at the end of 2022.

The significant decline in cash reserves is attributable to the company's aggressive investment strategy throughout 2023. Key investments included the commissioning of a new CO₂ plant and the purchase of a fleet of Scania trucks to meet increasing demand for the product.

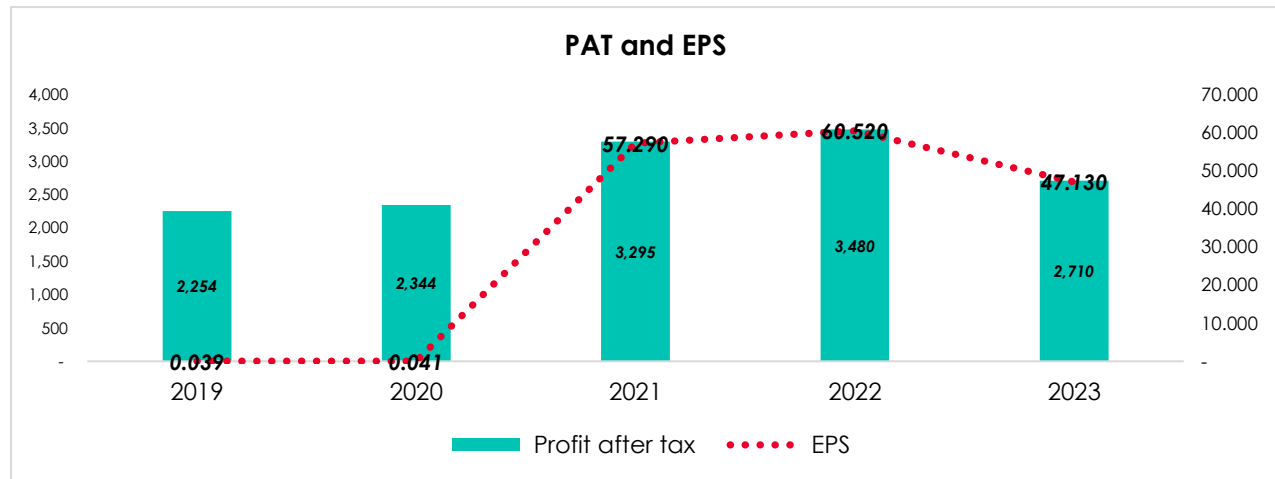
Additionally, the company has a strategic plan to diversify its portfolio by investing in Compressed Natural Gas (CNG) and Liquefied Petroleum Gas (LPG) to capitalize on the growing demand for cleaner energy sources. This may potentially open new revenue streams.

With a low current ratio, as evidenced in the TZS 2.47Bn gap between current liabilities and current assets, the company remains solvent, on the back of a one-year grace period on its loan with DTB. The completion of a government project to supply, install, and commission manifold systems for health facilities across the mainland is expected to bring in an additional TZS 2.9Bn in 2024. In 2023, the company had a CAPEX of TZS 5.4Bn.

Profitability

In 2023, the company recorded a PAT of TZS 3.8Bn, a 39% decline from the previous year's PAT of TZS 6.2Bn. The drop was primarily due to a delay in scheduled plant commissioning. The manufacturer experienced delays in the arrival of critical plant equipment, unreliable power supply and heavy rains which affected plant installation. These issues delayed the commissioning of the Ikama II Carbon Dioxide (CO₂) plant, which was intended to double production capacity.

The plant, initially scheduled to begin operations in September 2022, was delayed until December 2023, hence impacting revenues.



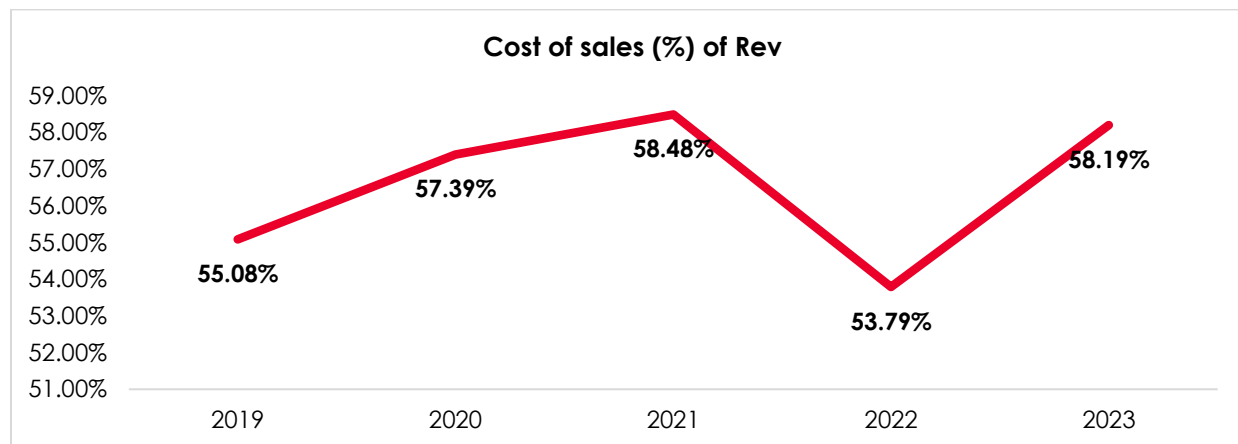
Source: Company Annual Reports, NCBA IB Research

Investment risks

Cost pressures

TOL's operating margin has experienced fluctuations over the years due to number of factors. These include; increased operating costs, pricing pressures and market demand dynamics.

In 2023, the company reported an operating margin of **20.09%**, down from 28.05% in 2022. The decline was attributable to operating challenges, including an uptick in energy costs and higher administrative expenses. Increased cost of sales, which reached TZS 14.9Bn, compared to TZS 13.75Bn the previous year impaired profitability.



Source: Company Annual Reports, NCBA IB Research

Operating in a capital-intensive industry, TOL has significant capital expenditure for maintenance and installation of modern plants and relevant technologies. The capex to revenue ratio has averaged at 24% in the last nine years to 2023, the highest being 37% in 2020 following the

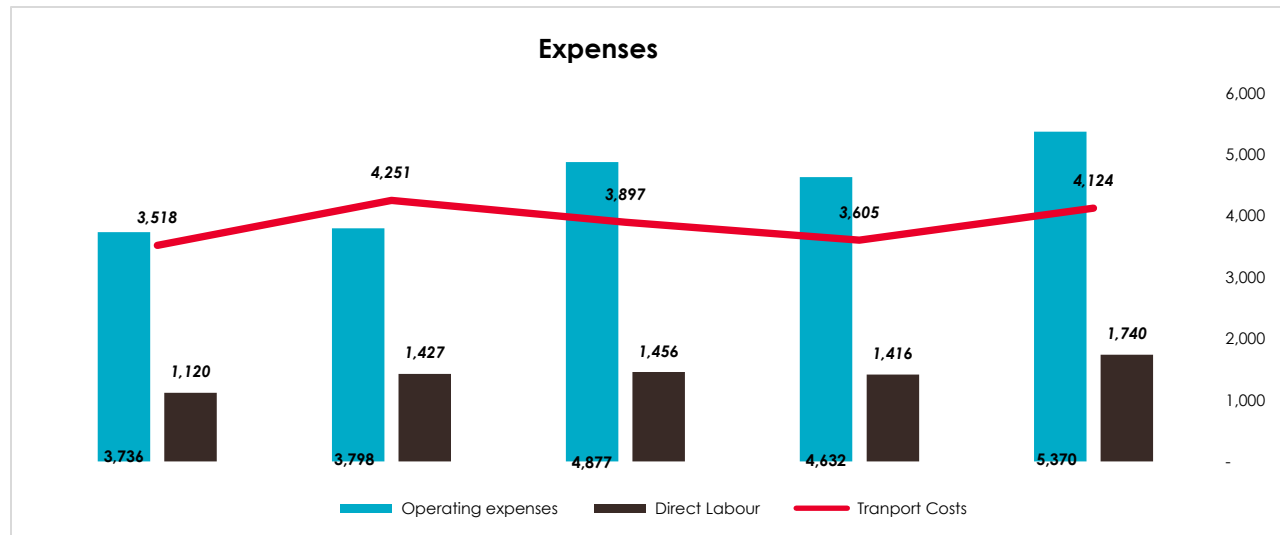
installation of a new Air Separation Unit (ASU) with a 90% utilization capacity, to replace the old Aspen 1000 plant which had a utilization capacity of 25% according to the company's reports. As a result of capital intensity, depreciation cost is one of the largest elements of direct cost of sales, but rather minute compared to operating expenses.

Surge in expenses

The firm's transport costs have grown at a CAGR 17.7% from TZS 3Mn in 2019 to TZS 4Mn in 2022.

The company reported an increase in selling, general, and administrative (SG&A) expenses, rising to TZS5.37 Bn in 2023, up from TZS 4.6Bm in 2022. This was driven by the company's expansion efforts and operational complexity.

With electricity being a key component in the production process, power outages and inconsistent supply could continue to disrupt operations, leading to reliance on backup generators, raising overheads. This could affect the supply chain for industries that depend on TOL Gases for oxygen, nitrogen, and acetylene, impacting sectors such as healthcare, manufacturing, and construction.

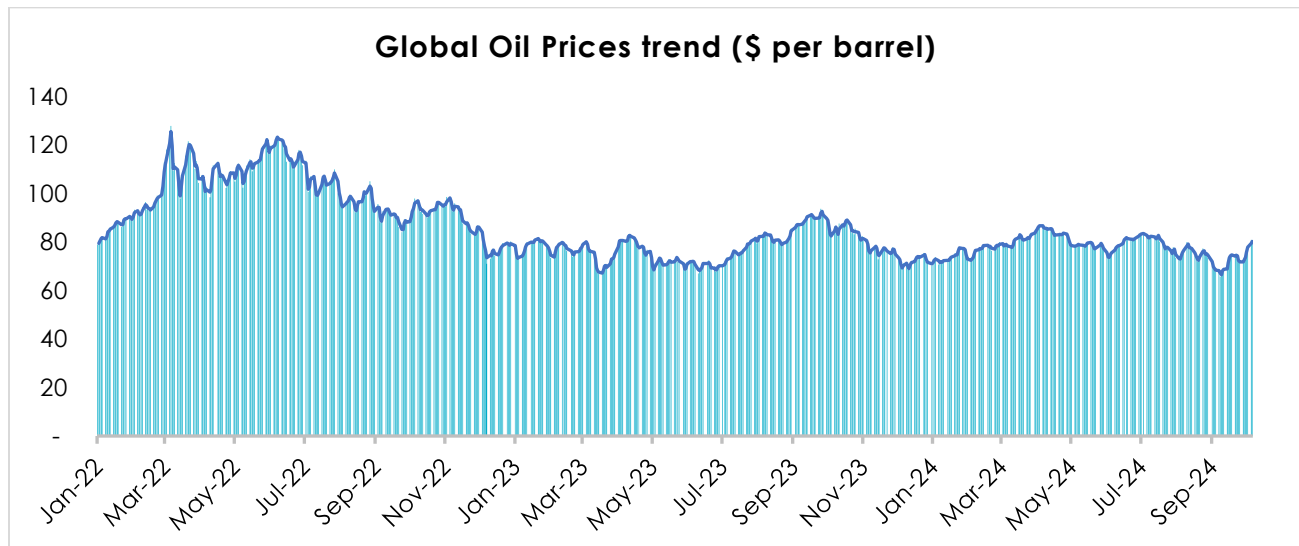


Source: Company Annual Reports, NCBA IB Research

Fuel costs

In Tanzania, fuel prices have experienced significant fluctuations over the past few years, largely influenced by global market dynamics. Throughout 2023 and 2024, gasoline prices remained high due to global supply chain disruptions and fluctuating crude oil prices.

In 2022, gasoline prices ranged from about TZS 2,800 to TZS 3,200 per litre. By the end of 2022, the price of gasoline had increased by approximately **21%**, impacted by the removal of a fuel subsidy in January 2023.



Source: OPEC, Bloomberg, NCBA IB Research

Manufacturing companies are by definition energy intensive, and increased fuel costs has a direct impact on overall production. Manufacturing companies are one of TOL's main customers, and if their capacity is constrained, TOL's revenues suffer in tandem.

In 2023, EBITDA declined by 20% to TZS 7.8Bn from TZS 9.9Bn in 2022 caused by production costs attributable to the use of generators to run the plant following the national grid power rationing. Electricity costs have risen by 113.06% from TZS 0.71Bn in 2020 to a staggering TZS 1.50Bn in 2024. In April 2023, there was a price change in electricity when TANESCO announced a tariff adjustment. The price per kilowatt-hour for industrial users saw an increase of approximately 8%.

Competition

TOL gases vs KAMAL gases and other players.

TOL faces significant competition, particularly in Kenya, where it competes with BOC Kenya, a subsidiary of the global giant Linde PLC. BOC's extensive distribution network, advanced technology, and dominance in key segments such as oxygen, nitrogen, and acetylene gases create substantial barriers for TOL in securing a strong market share in Kenya.

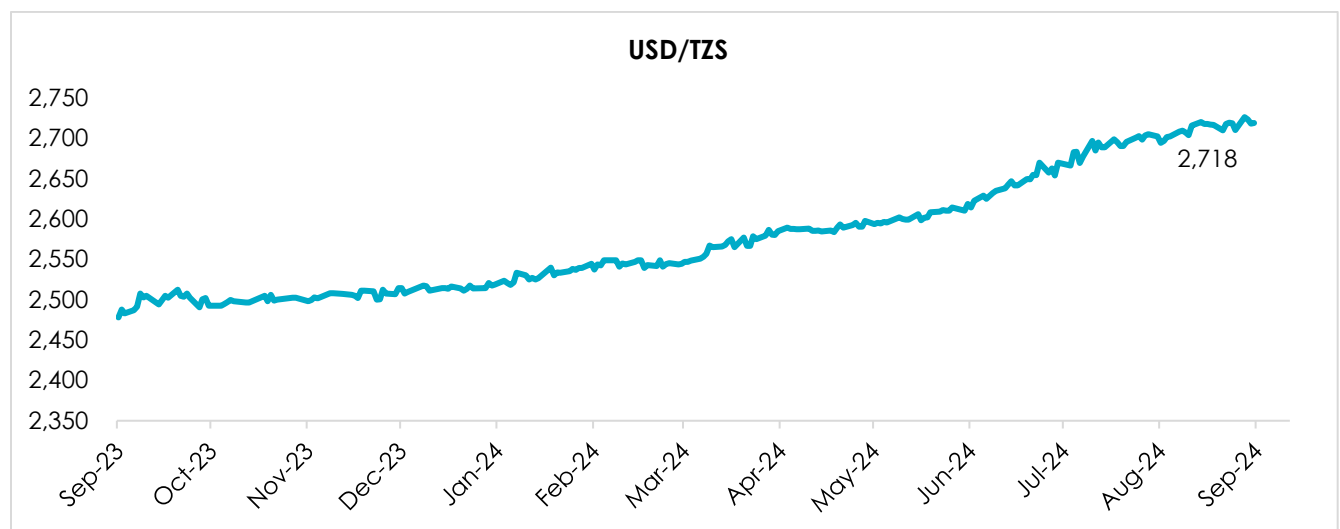
In contrast, TOL maintains leadership in Tanzania, contending with domestic players like Kamal Gases, Salima Oxygen Limited, O2 Limited, Mwanza Gas Limited, and GSF Oxygen Plant.

In regard to its expansion ambitions, TOL faces challenges in cross-border operations, particularly in Uganda. The high logistical costs of operating in a landlocked country, coupled with competition from local suppliers like Oxygas Limited, make the Ugandan market difficult to penetrate. As a result, TOL has prioritized reinforcing its presence in Tanzania while cautiously expanding into other East African markets.

Currency

In 2023, TZS declined by 7.8% against the USD. This has a direct impact on the Group since the costs of imports, suppliers, and other products in the supply chain are highly correlated to the exchange rate. This in turn puts a strain on overall profitability.

Exposure to foreign exchange risks due to importation of raw materials and suppliers' preference for payments in foreign currency are expected to impact production costs. TOL generates revenue in Tanzanian Shillings (TZS), but payments for capital goods and raw materials are made in foreign currency.



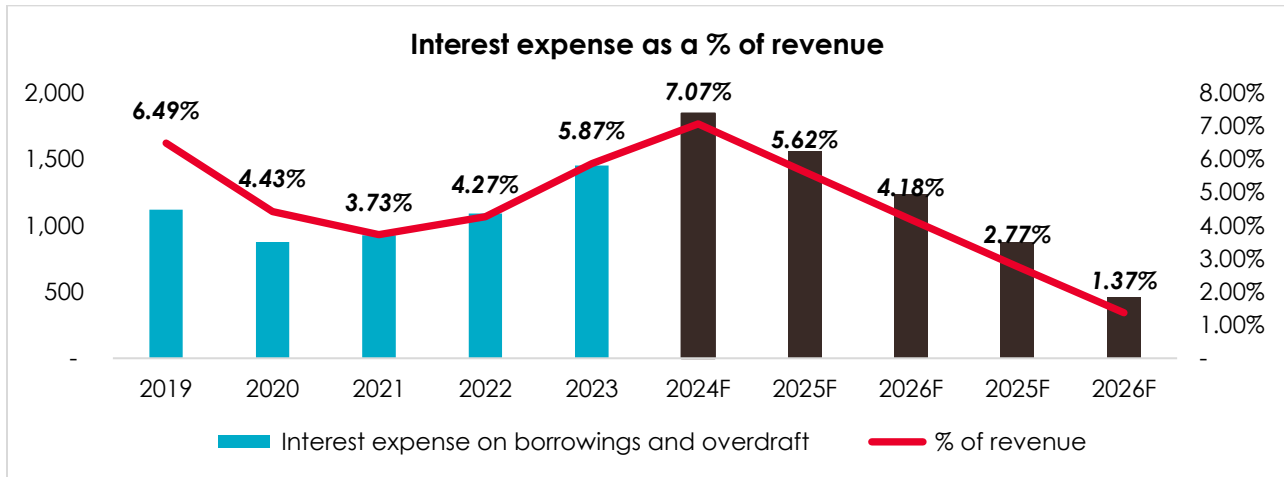
Source: Company Annual Reports, NCBA IB Research

Interest expense

The modernization and installation of plants has required the company to exploit a series of financing programmes from commercial banks thus maintaining a consistent level of finance costs, at an average of 5% of total revenue for the last five years.

To the management's credit, they have consistently gone for cheaper re-financiers in the new negotiations. In 2021, the company secured a TZS 14.48bln loan at 12.75% p.a partly to refinance two previous facilities that costing 14% p.a each.

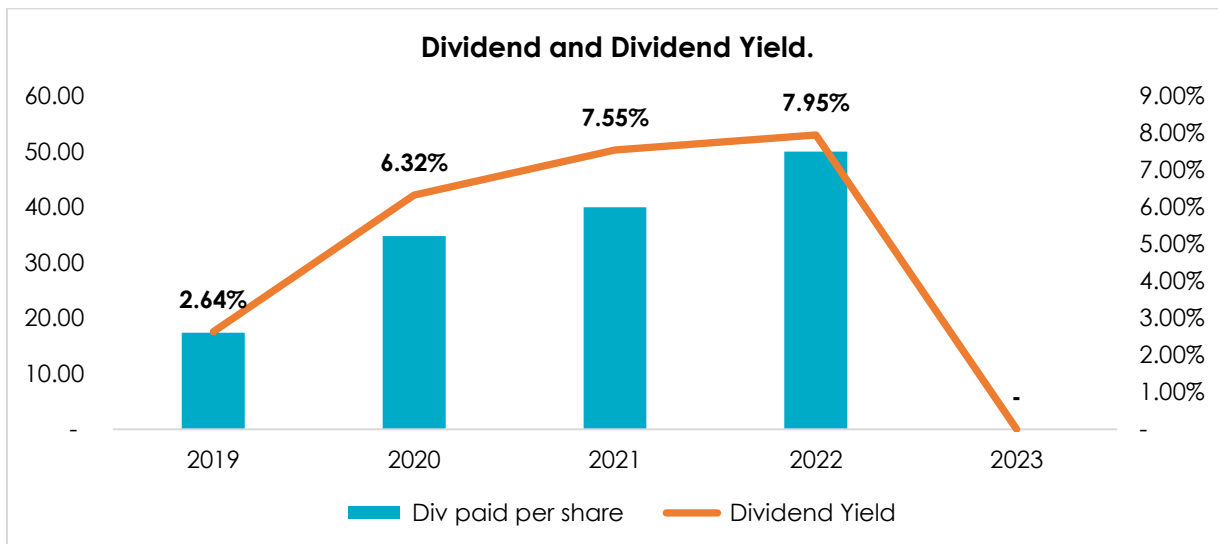
In order to finance its expansion strategy, TOL will still need credit. As a result, we expect its cashflows to be impacted by higher financing costs coupled with capex.



Source: Company Annual Reports, NCBA IB Research

Unstable dividend pay-out

The company paid a dividend of TZS 17.4 per share in 2018, the first since its listing in 1998. Dividends have increased to TZS 40/- per share in 2021, while the payout ratio has also risen from 38% in 2018 to 85% in 2020 and 70% in 2021. In 2022, the company raised its dividend to TZS 50 per share, a 25% increase, marking its commitment to returning capital to shareholders.



Source: Company Annual Reports, NCBA IB Research

Comparison with peer companies

TOL is comparable to Carbacid Kenya, BOC Kenya, Les Gaz Industriel Ltd Mauritius, Industrial and Medical Gases Nigeria and Air Liquide Tunisia. These are all major players in the gas and gas-related production and services sectors.

Company	P/E	EV/EBITDA	EBITDA Margin	ROE
TOL Gases	11.47	5.79	38.25%	14.00%
BOC	7.37	4.59	25.00%	11.42%
Carbacid	6.57	3.64	67.24%	20.53%
Les Gaz Industriel Ltd	11.08	9.73	9.90%	6.29%
Industrial and Medical Gases	8.50	4.30	16.28%	22.19%
Air Liquide Tunisie	5.84	3.29	10.58%	22.53%
AVERAGE	8.47	5.22	27.88%	16.16%

Outlook

We believe the company will deliver a relatively strong performance on the back of the following;

- **TOL Gases' entry into the natural gas market**

This presents significant potential to boost its operating margins in the medium to long term. By capitalizing on Tanzania's rich natural gas reserves and growing demand from both industrial and household sectors, TOL stands to benefit from revenue diversification and reduced reliance on imported products.

The scalability of natural gas, combined with lower transportation and energy costs through local sourcing, could enhance margins. Although initial capital investments in infrastructure may temporarily compress margins, the long-term benefits—such as vertical integration, pricing power, and economies of scale—are likely to outweigh these challenges.

With strategic execution and growing demand for cleaner energy alternatives, TOL Gases could solidify its position as a key player in Tanzania's energy sector, despite competition from major local and international companies.

- **Industrialization**

Tanzania's ongoing industrialization is a significant driver of demand for industrial gases, such as oxygen, nitrogen, and argon. As the manufacturing sector expands, TOL Gases can capitalize on the increased demand.

- **Healthcare infrastructure**

The expansion of healthcare facilities in Tanzania is creating a growing market for medical gases, including oxygen and nitrous oxide. TOL Gases can benefit from this trend by increasing its supply and distribution of these essential products.

Market position

In Tanzania, TOL remains a leading player, competing with domestic companies like Kamal Gases, Salima Oxygen Limited, O₂ Limited, Mwanza Gas Limited, and GSF Oxygen Plant.

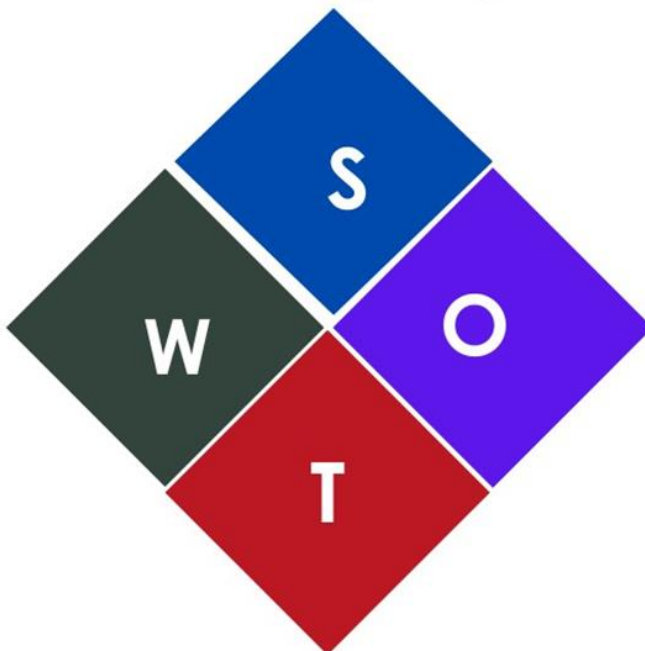
TOL's growth strategy is anchored on substantial investments in infrastructure, such as a new carbon dioxide plant and an expanded fleet, which will increase production capacity over the next five years. These efforts are intended to meet rising demand and improve service delivery, positioning the company to leverage economies of scale.

Global disruptions, inflationary pressures, weakening currency, increasing costs of operations will be major challenges for the rest of the financial year. Scarcity of the greenback in regional markets also pose a risk to the business.

The company has growth opportunities in all major geographical regions and in diverse end-markets such as healthcare, chemicals, energy, manufacturing, metals and mining, food and beverage as well as electronics.

SWOT analysis

SWOT ANALYSIS



Strengths

- Tol Gases, a long-standing player in the Tanzanian market, boasts a strong brand.
- Tol Gases provides a diverse portfolio of industrial and medical gases, catering to the needs of multiple industries, including healthcare, manufacturing, and agriculture.

Weaknesses

- The company's heavy reliance on the Tanzanian market makes it susceptible to local economic instability and regulatory shifts.
- The company's cash flow situation is strained, forcing it to take on debt and overdraft to maintain its operations.

Opportunities

- The burgeoning industrial and medical sectors in Tanzania, fueled by economic growth, offer significant potential for expanding gas sales
- By investing in cutting-edge technology, the company can enhance production efficiency, lower costs, and strengthen its competitive position.

Threats

- Rising competitive pressures from new entrants or intensified competition from existing players and government could erode margins and market share.
- Reliance on a steady supply of raw materials and energy exposes TOL to risks associated with disruptions, which could negatively impact..

We derive our target price by blending DCF, EV/EBITDA and P/E approaches to arrive at a 12-month target price of **TZS 710.07** for **TOL Gases Ltd.**

The target price implies a upside of **4.4%** to the current trading price of **TZS 680.00** as of 19th November 2024.

Valuation Methodology	Implied Price	Weighting	Weighted Value
DCF Approach	(353.39)	20%	(70.21)
EV/EBITDA	1,102.83	60%	661.70
P/E Approach	595.25	20%	119.05
Fair Value		100%	710.53
Current Price (23rd Sep 2024)			680.00
Upside/(Downside)			4.5%

Assumptions

- Risk free rate of 10.25% based on the 10-year Treasury bond yields.
- Tax rate of 30%.
- Equity risk premium of 12.6%.
- Beta of 0.73 on stock's relative volatility on the index.
- Long term growth rate of 6.0% based on GDP growth forecast for 2024

Rating definitions

BUY – Total expected 12-month return (incl. dividends) greater than 20%

ACCUMULATE - Total expected 12-month return (incl. dividends) between 10% - 20%

HOLD – Total expected 12-month return (incl. dividends) between 0% -10%

SELL – Total expected 12-month return (incl. dividends) less than 0%

Investment recommendation

We recommend a **HOLD** based on a target price of **TZS 710.07** implying a 4.4% return on the current market price of TZS 680.00 as of 19th November 2024.

The recommendation is based on the company's revamped business strategy underpinned by productivity, driven by continuous improvement initiatives.

The expectation for increased regional demand and opportunities in new markets will underpin the company's growth and profitability.

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