

EQUITY RESEARCH TOL

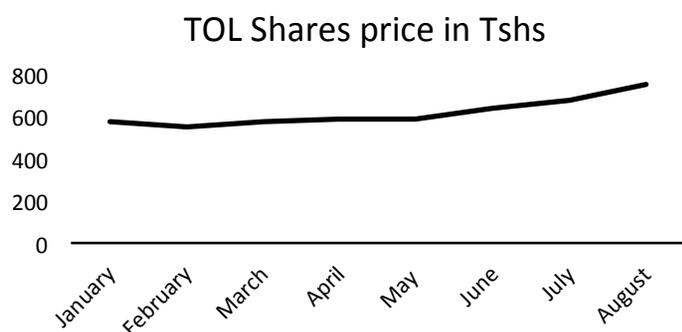
September 2015



CORPORATE FINANCE | ASSET MANAGEMENT | STOCKBROKING | INFRASTRUCTURE ADVISORY

HIGHLIGHTS

Recommendation	SELL
DSE Code	TOL
Issued Shares	55,835,490
Current Price (TZS)	750
Targer Price (TZS)	664
Downside	-12%
Dividend Yield	N/A
Market Cap (TZS Bn)	41.88
Year End December	December
Exchange rate: USD/TZS	2,160
Country Data	
Population	49.63Mn
GDP Growth 2014E	7%
GDP Growth 2015E	8%
National Debt % of GDP	54%
Inflation rate (July 2015)	6.4%



We initiate our coverage on TOL Gases Limited with a **SELL** recommendation in the **Medium Term**.

We base our target price at TZS 664 which represents a potential **downside** of 12 % on the current share price of TSZ 750. From 2011 when TOL started implementation of its turn around strategy to 2014, the company revenue and Profit grew at a CAGR 25.73% and 156% respectively. We expect the company to ahead and implement phase II of the turn around strategy and clear the accumulated losses in 2015.

Value Drivers

New products

The company is expected to start producing pure argon and bulk liquid oxygen and nitrogen. These products are expected to increased the company's topline going forward.

Expansion to new geographical areas

TOL has already started to expand its market into the neighboring countries. It is already supplying in Zambia through a contract supply and plans to go to Kenya and Zimbabwe in the near future.

Increased efficiency

The on going rehabilitation of the ASPEN project is expected to lower operating (power) costs and increase efficiency through production by batch method.

Improved product reliability and market share

Carbon Dioxide line (CO2) is expected to continue growing as the company demonstrates its reliability and consistency in supplying food grade CO2 to both local and neighboring markets

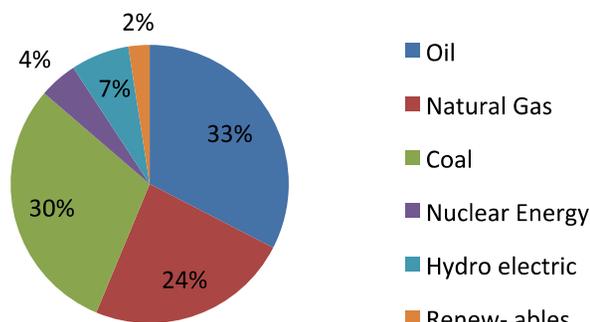
Key Risks

Increased Competition

Major risk faced by TOL increased competition from outside the country and importation of cheaper products from outside Tanzania

Global Energy Review

Global Energy Consumption



Global primary energy consumption decelerated sharply in 2014, even though global economic growth was similar to 2013.

Million tos oil equivalent	2010	2011	2012	2013	2014
Total World	12,110.77	12,408.31	12,586.10	12,807.15	12,928.40
OECD	5,607.28	5,547.53	5,493.85	5,548.47	5,498.76
Non-OECD	6,503.48	6,860.78	7,092.25	7,258.68	7,429.64
EU	1,757.23	1,697.18	1,689.23	1,675.90	1,611.36
Former USSR		1,029.40	1,034.39	1,016.91	
	987.20				999.26

Source: Published financial accounts

Global Energy Overview

Consumption increased for all fuels, reaching record levels for every fuel type except nuclear power; production increased for all fuels except coal.

For oil and natural gas, global consumption growth was weaker than production. The data suggest that global CO2 emissions from energy grew at their slowest rate since 1998, other than in the immediate aftermath of the financial crisis.

Emerging economies accounted for all of the net growth in energy consumption, as they have on average over the past decade, although growth in these countries was well below its 10-year average.

Chinese consumption growth was the slowest since 1998, yet China still recorded the world's largest increment in primary energy consumption for the fourteenth consecutive year.

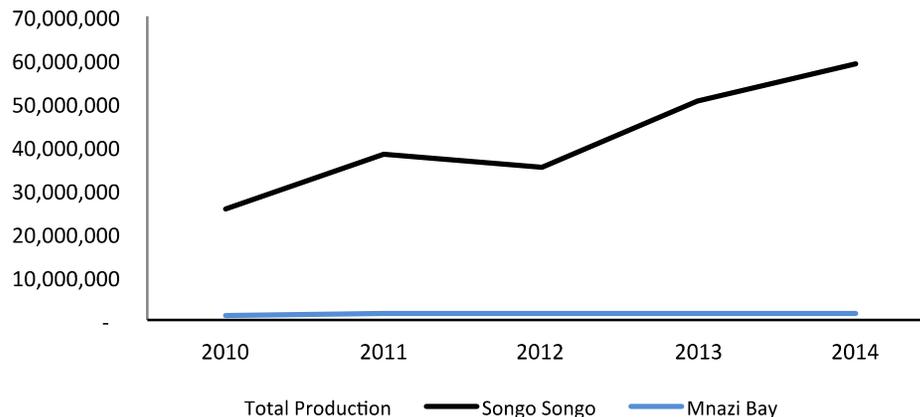
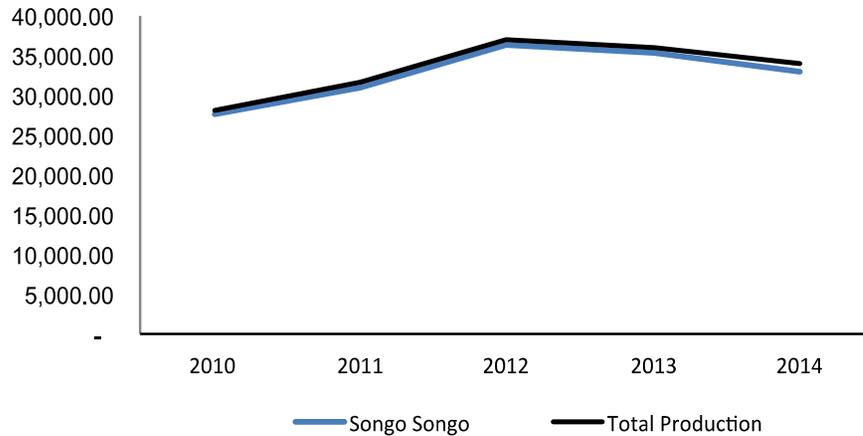
OECD consumption experienced a larger than average decline, with weakness in the EU and Japan offsetting above average growth in the US.

Energy consumption in the EU fell to its lowest level since 1985.

Energy price developments in 2014 were generally weak, with oil and coal prices falling globally. Gas prices fell in Europe, were relatively

flat in Asia, and rose in North America. The annual average price for Brent, the international crude oil benchmark, declined reflecting a sharp fall in prices in the second half of the year. The differential between Brent and the US benchmark West Texas Intermediate (WTI) narrowed but remained elevated relative to past levels. As with crude oil prices, differentials between

Tanzania Energy Sector



Source: 1) Published Accounts

Gas activities in the country 2014

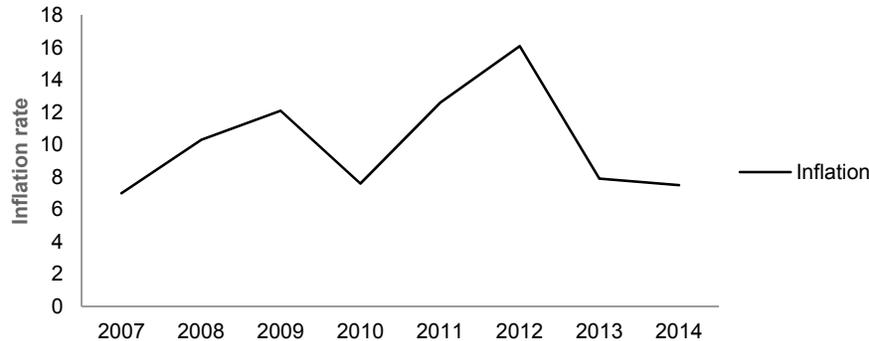
► In 2014, economic activities in the electricity and gas grew by 9.3% compared to 13% achieved in 2013. The growth resulted from increased Hydropower generation due to improved weather condition. Economic activities from electricity and gas contributed 0.8% of the GDP which is the same as 2013's contribution.

► Gas exploration activities in various geographical areas continued in 2014 resulting to a total of natural gas discovered of 6.78 c3sqf trillion in the deep sea. This makes a total of discovered natural gas to be square feet 55.08. However, natural gas production in 2014 went down by 5.8% to square feet 33.85 billion from 35.93% billion which was produced in 2013. Out of the amount produced in 2014, 90% was consumed by TANESCO to generate power and the rest was used in factories.

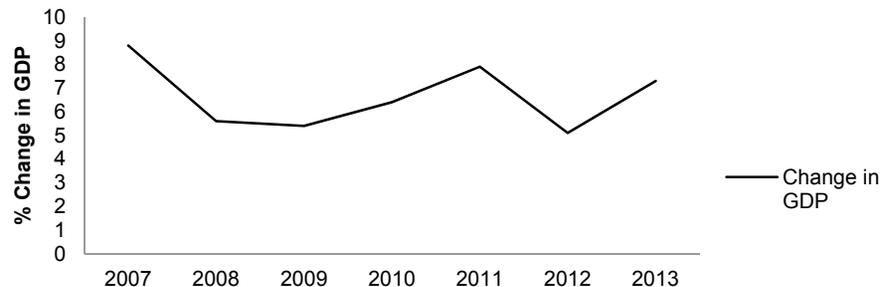
► Despite lower Gas production in 2014, revenues from sales of natural gas increased in 2014 reaching to USD 60.5 million compared to USD 52.1 which was received in 2013. This is equal to 16% increase.

Economic overview

Growth Rate of Gross Domestic Product (GDP) – Annual Percentage



Inflation trend – (2007 – 2013)



SOURCES

1. Bank of Tanzania (www.bot-tz.org)
2. National statistics bureau of Tanzania (www.mbs.go.tz)

Economic Overview

GDP

Tanzania achieved an average growth of 6.74% from 2010 to 2014. The main contributors to growth in 2014 were construction which accounted for 18.8 percent of the growth, wholesale and retail trade (14.3 percent), agriculture (11.6 percent), transport and storage (10.8 percent), manufacturing (7.2 percent).

Financial and Insurance activities contributed 3.4% of the total GDP in 2014.

Inflation

Annual headline inflation eased to an average of 4.1 percent in the quarter ending March 2015 compared with an average of 5.5 percent in the preceding quarter and 6.0 percent recorded in the corresponding quarter in 2014. This moderation in inflation was mainly on account of a decrease in food, energy and fuel prices.

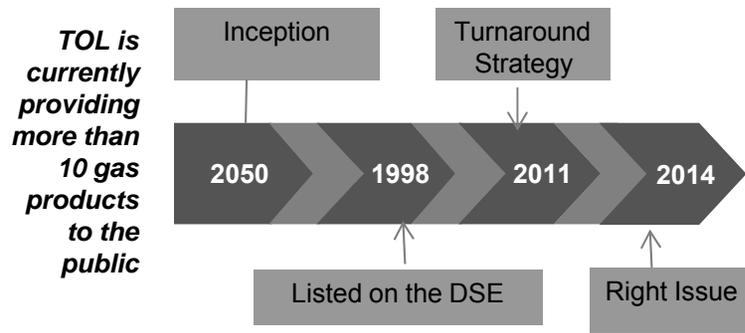
Exchange rates (Tshs:USD)

The Tanzania shilling has been relatively stable from 2011 to 2014. However, since the beginning of 2015, it has failed to hold against the US dollar (TZS 2,020.34/ 1 USD as at 30th June 2015) and currencies of other major trading partners.

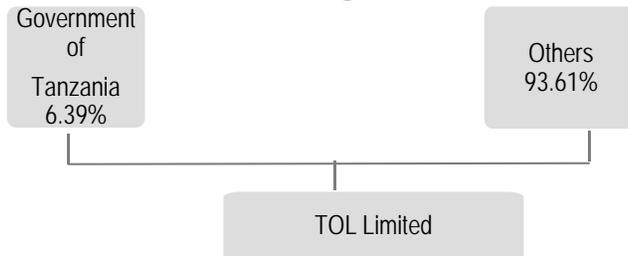
Currency risk remains high with the TZS/USD exchange rate depreciating at an average rate of 5.18% per annum over the last five years.

Business overview

Key Milestones



Shareholding Structure



Source: TOL & Optima Analysis

Background and history to the business

The company main activities is production and distribution of industrial gasses, medical gasses and related associeries.

The current range of products include:

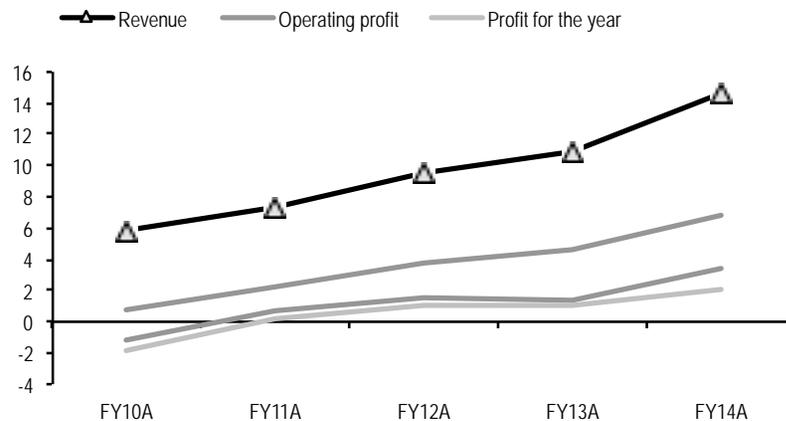
- Oxygen
- Compressed air
- Carbon dioxide
- Hydrogen
- Nitrogen
- Ammonia
- Argon
- Nitrogen Oxide
- Helium
- Acetylene
- Welding

Currently, TOL is has customers in Malawi, Zambia and DRC and plans to expand to Kenya, Zimbabwe and Mozambique.

TOL Company Overview

Performance Trend

Currency: Tshs '000	FY10A	FY11A	FY12A	FY13A	FY14A	CAGR
Revenue	5,846,726	7,352,088	9,555,089	10,832,491	14,610,979	25.73%
Cost of Sales	(5,089,935)	(5,175,224)	(5,827,514)	(6,234,812)	(7,807,317)	11.29%
Gross Profit	756,791	2,176,864	3,727,575	4,597,679	6,803,662	73.16%
Other Income	40,320	669,585	612,327	358,841	693,945	103.68%
Operating Expenses	(1,992,295)	(2,097,097)	(2,730,272)	(3,599,883)	(4,073,433)	19.58%
Operating profit	(1,195,184)	749,352	1,609,630	1,356,637	3,424,174	
Finance costs	(297,655)	(339,400)	(232,495)	(411,115)	(1,133,513)	39.69%
Profit before tax	(1,492,839)	409,952	1,377,135	945,522	2,290,661	
Income tax expense	(370,142)	(289,984)	(425,035)	52,968	(269,494)	-7.63%
Profit for the year	(1,862,981)	119,968	952,100	998,490	2,021,167	



Source: 1) Published Accounts

Company overview

- ▶ Traditionally TOL competitive advantage has been its quality products. This strategy served it well for some years when TOL had a high monopoly over the industrial and medical gases market. Increased competition made this approach ineffective.
- ▶ TOL was forced to come up with a plan that would enable the company to compete not only on quality, but also on price and customer services.
- ▶ In 2011, TOL started to implement its turn around strategy (mission 6.3) which aimed at returning the company to profitability and record positive reserves.
- ▶ The turn around strategy involved three types of strategies namely:
 - ▶ **Strategies** for increasing **Sales Volume** while reducing production and operations costs.
 - ▶ **Strategies** for running efficient **Operations**.
 - ▶ **Strategies** for getting and giving the best performance from and to our **People** (staff)

Tanzania Oxygen Limited Overview - Continued

Balance sheet growth

Currency: Tsh '000'	FY10A	FY11A	FY12A	FY13A	FY14A	CAGR
Non-current Assets						
Property, Plant and Equipment	5,669,321	5,835,582	11,663,952	13,232,964	16,691,603	31%
Intangible Assets	-	76,566	64,581	68,898	64,134	
Total Non-Current Assets	5,669,321	5,912,148	11,728,533	13,301,862	16,755,737	31%
Current Assets						
Inventories	418,707	318,804	1,071,544	1,963,384	3,005,748	64%
Trade and other receivables	804,342	2,383,754	1,215,152	2,393,700	4,070,920	50%
Taxation recoverable	68,676	-	-	-	-	-100%
Cash and bank balances	128,829	161,839	214,729	611,836	89,016	-9%
Total Current Assets	1,420,554	2,864,397	2,501,425	4,968,920	7,165,684	50%
Total Assets	7,089,875	8,776,545	14,229,958	18,270,782	23,921,421	36%
EQUITY AND LIABILITY						
Equity						
share capital	3,722,369	3,722,369	3,722,369	4,356,245	5,583,553	11%
share premium	3,739,087	3,739,087	3,739,087	3,739,087	6,263,338	14%
accumulated losses	- 5,868,502	- 5,748,535	- 4,796,434	- 3,798,092	- 1,776,925	-26%
	1,592,954	1,712,921	2,665,022	4,297,240	10,069,966	59%
Non current liabilities						
Long term borrowings	448,006	2,008,280	5,009,540	6,683,050	6,382,540	94%
Deffered tax liability	370,142	660,126	1,077,973	685,745	955,238	27%
	818,148	2,668,406	6,087,513	7,368,795	7,337,778	73%
Current Liabilities						
Trade and other payables	2,963,425	2,683,137	3,086,679	2,267,079	2,282,520	-6%
Tax payable	-	-	7,188	339,260	39,260	
Bank overdraft	527,569	774,686	958,316	2,397,977	2,462,716	47%
cylinder deposit	791,308	640,060	341,476	498,861	627,611	-6%
Current portion of loans	396,470	297,336	1,083,764	1,101,570	1,101,570	29%
Total Current Liabilities	4,678,772	4,395,219	5,477,423	6,604,747	6,513,677	9%
Total Equity and Liabilities	7,089,874	8,776,546	14,229,958	18,270,782	23,921,421	36%

Source: 1) Published Accounts

- ▶ TOL financial performance improved substantially in the last five years from 2010 to 2014 from a loss making company to a profitable company.
- ▶ Growth in the profitability results from successful implementation of the turnaround strategy which started in 2011 and resulted into a profit in the first year of implementation.
- ▶ First round of the rehabilitation of the Aspen plant was completed which resulted increased reliability and efficiency. Below are some of the apparent results of the rehabilitation:
 - ▶ On average the plant is producing at 80% to 90% efficiency
 - ▶ Total power consumption per cubic meters of gas produced has gone down by 43%
 - ▶ The plant can now produce crude organ and is expected to be able to produce pure organ in the second phase of the repairs expected in the last quarter of 2015
 - ▶ Increased storage capacity for liquid gas which will ensure continuous availability of industrial gas in the market and save cost through production by batch method.
- ▶ Carbon dioxide (CO₂) line continues to grow as the company continues to demonstrate its reliability and consistency of supply of high quality food grade CO₂ to both local and foyer bottling customs.

Projected Financial Statements

Performance Trend

Currency: Tsh '000'	FY14A	FY15B	FY16B	FY17B	FY18B	CAGR
Revenue	14,610,979	19,778,547	21,695,664	23,801,455	26,114,636	16%
Cost of Sales	(7,807,317)	- 7,463,472	- 8,186,902	- 8,981,527	- 9,854,410	6%
Goss Profit	6,803,662	12,315,075	13,508,762	14,819,928	16,260,226	24%
Other Income	693,945	-	-	-	-	-100%
Operating Expenses	(4,073,433)	(3,178,796)	(3,337,736)	(3,504,623)	(3,679,854)	-3%
Depreciation						
Operating profit	3,424,174	9,136,279	10,171,026	11,315,305	12,580,372	38%
Finance costs	(1,133,513)	- 1,053,513	- 727,638	- 491,053	- 260,006	-31%
Profit before tax	2,290,661	8,082,766	9,443,388	10,824,252	12,320,366	52%
Income tax expense	(269,494)	- 2,424,830	- 2,833,016	- 3,247,276	- 3,696,110	92%
Profit for the year	2,021,167	5,657,936	6,610,371	7,576,976	8,624,256	44%

Projections overview

TOL projects a 16% CAGR growth from 2015 to 2018.

Value drivers are expected from the following :

► **New products:** The company is expected to start producing pure argon and bulk liquid oxygen and nitrogen. These products are expected to increased the company's topline going forward.

► **Expansion to new geographical areas:** TOL has already started to expand its market into the neighboring countries. It is already supplying in Zambia through a contract supply and plans to go to Kenya and Zimbabwe in the near future.

► **Increased efficiency:** The on going rehabilitation of the ASPEN project is expected to lower operating (power) costs and increase efficiency through production by batch method.

► **Improved product reliability and market share:** Carbon Dioxide line (CO2) is expected to continue growing as the company demonstrates its reliability and consistency in supplying food grade CO2 to both local and neighboring markets

Six months performance – June 2015

Currency: Tsh '000'	FY15B	6 Months Results	Annualised Results 2015
Revenue	19,778,547	6,921,424	13,842,848
Cost of Sales	(7,463,472)	(3,937,191)	(7,874,382)
Goss Profit	12,315,075	2,984,233	5,968,466
Other Income			
Operating Expenses	(3,178,796)	(1,565,807)	(3,131,614)
Depreciation			
Operating profit	9,136,279	1,418,426	2,836,852
Finance costs	(1,053,513)	(519,300)	(1,038,600)
Profit before tax	8,082,766	899,126	1,798,252
Income tax expense	(2,424,830)	(269,738)	(539,476)
Profit for the year	5,657,936	629,388	1,258,776

Source: 1) Published Accounts

Projected Balance Sheet

Currency: Tsh '000'	FY15B	FY16B	FY17B	FY18B
ASSETS				
Non-current Assets				
Property, Plant and Equipment	15,102,011	14,717,618	13,188,731	12,189,046
Intangible Assets	40,412	16,689	-	-
Total Non-Current Assets	15,142,422	14,734,307	13,188,731	12,189,046
Current Assets				
Inventories	1,977,855	2,169,566	2,380,145	2,611,464
Trade and other receivables	7,626,113	8,796,533	9,779,396	10,768,210
Cash and bank balances	1,637,374	7,750,264	16,704,006	27,413,814
Total Current Assets	11,241,342	18,716,364	28,863,547	40,793,487
Total Assets	26,383,764	33,450,671	42,052,278	52,982,534
EQUITY AND LIABILITY				
share capital	8,189,111	8,189,111	8,189,111	8,189,111
share premeum	3,739,087	3,739,087	3,739,087	3,739,087
accumulated losses	1,112,015	4,684,993	8,929,766	13,897,973
Equity	13,040,213	16,613,191	20,857,964	25,826,171
Non current liabilities				
Long term borrowings	3,172,380	2,070,810	969,240	162,595
Deffered tax liability	685,743	685,743	685,743	685,743
	3,858,122	2,756,553	1,654,983	848,338
Current Liabilities				
Trade and other payables	5,363,218	9,264,800	14,018,964	20,024,638
Tax payable	2,424,830	2,833,016	3,247,276	3,696,110
Dividend payable	1,697,381	1,983,111	2,273,093	2,587,277
Total Current Liabilities	9,485,429	14,080,928	19,539,332	26,308,024
Total Equity and Liabilities	26,383,764	33,450,671	42,052,278	52,982,534

Source: 1) Published Accounts

Projections overview

Key Risks

► Increased Competition

Increased competition from other players and the reduced TOL's market share in the industrial and medical gases industry in Tanzania is a key risk faced by TOL in the medium term.

Valuation Results

Company	Country	Trailing PE	Trailing P/B
BOC	Kenya	10.54	1.66
CARBACID	Kenya	8.24	2.45
TOL	Tanzani	33.27	3.82

Source: DSE,NSE and Optima Analysis

DCF Business Value	43,024,853
Add: Cash & cash equivalent	150,443
Loans	(6,117,795)
Equity value to TOL Shareholders	37,057,501

Market Multiples Comparison

The company is currently trading at Trailing PER of 33.27 x (on annualized earnings) and a Trailing P/Bs valuation of 3.82x relatively on the higher side when compared to its key regional competitors BOC Gases & CARBACID that are trading at trailing PERs of 10.54x and 8.24 x respectively and P/BV of 1.66x and 2.45 x respectively.

Discounted Cashflow Valuation

We have used DCF method to arrive at the price of Tshs **664** which is 12% below the closing market price of Tshs 750 as on the 14th September 2015.

Our Valuation is based on the following assumptions:

- ▶ The company will go ahead and complete phase II of ASPEN project rehabilitation which is expected to increase efficiency.
- ▶ TOL will continue implementing agreed strategies in the turnaround strategy
- ▶ Based on 6 months results, TOL will not be able to achieve its annual budget of Tshs 19.7 billion revenue. As a result we have adjusted management projections downwards.

Important Information

Analyst' stock ratings are defined as follows:

Outperform/Buy: The stock is of good value, is currently underpriced and have strong fundamentals

Neutral/Hold: The stock is correctly valued with little upside or downside pricing

Underperform/Sell: The stock is currently overpriced, its total return is expected to underperform; it has weak fundamentals and challenging operating environment

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