12 March 2020

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Buy (Maintained)

Compelling Valuations; Reiterate BUY

Target Price (Return):	SGD1.30 (+34%)
Price:	SGD0.97
Market Cap:	USD597m
Avg Daily Turnover (SGD/USD)	0.59m/0.43m

- **BUY, new SGD1.30 TP from SGD1.55, 34% upside plus c.5% yield.** We cut FY20-21F profit by 6-9% to reflect the decline in aviation traffic, especially in China. China Aviation Oil's share price has declined on anticipated near-term earnings weakness, but its monopolistic position in China and cost-plus business model ensures profit and cash flow generation. Moreover, a strong net cash balance sheet enables CAO to undertake large acquisitions. It is trading below its NTA/share of USD0.95 (c.SGD1.30), and at an ex-cash 2020 P/E of just 2.5x.
- **Will deliver profits despite the decline in jet fuel volume.** The COVID-19 outbreak has already stalled aviation traffic in China, and will continue to put brakes on international aviation traffic globally. We now expect a 20% decline in jet fuel import volumes into China, as well as a 20% decline in jet fuel pumped by Shanghai Pudong International Airport Aviation Fuel Supply (SPIA) in 2020. As the jet fuel imports into China is a cost-plus business, CAO will report profits, even if import volume declines. While SPIA (33%-owned by CAO) could see margin pressure amidst the decline in jet fuel pumped at the Shanghai Pudong International Airport (SPA), we expect the business to remain profitable.
- **Recovery in Chinese aviation traffic should support a re-rating.** With the gradual decline in new COVID-19 cases being reported in China, there is scope for an earlier-than-expected recovery in China's domestic aviation traffic. While this will not support the recovery in CAO's jet fuel import volumes that are dependent on China's international aviation traffic, SPIA could report better-than-expected jet fuel volumes for 2020. It is worth noting that SPIA accounts for c.65% of the CAO's PBT. Stronger-than-estimated results for SPIA for 2020 should also lead to a resumption of dividend payments to CAO, thereby further improving the latter's net cash position.
- **Valuations remain compelling.** Following the sharp decline in share price, CAO is now trading below its net tangible asset value per share and at 6.8x 2020F P/E (ex-cash FY20F P/E of just 2.5x). Our SGD1.30 TP implies 1.0x P/NTA, which we believe is reasonable for a profitable and FCF-generating business. In addition, given its significant net cash position (c.63% of its market cap); CAO should be in a position to undertake a sizable earnings-accretive acquisition.
- **Risks to our rating.** Key downside risks to our rating and TP are losses at its trading business despite all the risk control measures, opening up of the Chinese aviation fuel market risking CAO's monopoly, and a higher-than-estimated aviation traffic decline in 2020.

Analyst

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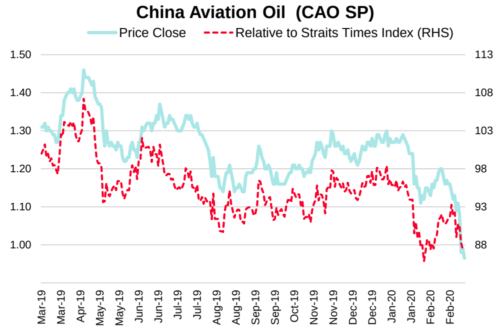
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(24.0)	(14.6)	(20.9)	(19.6)	(24.6)
Relative	(11.9)	(3.8)	(10.2)	(8.0)	(13.3)
52-wk Price low/high (SGD)					0.97 – 1.46



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	20,612	20,343	13,029	17,110	17,557
Recurring net profit (USDm)	94	100	88	97	105
Recurring net profit growth (%)	9.8	6.4	(11.6)	10.2	7.5
Recurring P/E (x)	6.36	5.98	6.77	6.14	5.71
P/B (x)	0.8	0.7	0.7	0.6	0.6
P/CF (x)	4.08	11.97	8.81	42.39	19.76
Dividend Yield (%)	4.8	4.7	4.9	4.9	4.9
EV/EBITDA (x)	8.23	4.65	3.56	2.83	1.22
Return on average equity (%)	12.6	12.4	10.2	10.5	10.5
Net debt to equity (%)	(46.5)	(45.4)	(50.3)	(50.5)	(53.1)

Source: Company data, RHB

Financial Exhibits

Asia
Singapore
Energy & Petrochemicals
China Aviation Oil
CAO SP
Buy

Valuation basis

Our TP is derived from an average of forward P/E, P/BV, EV/adjusted EBITDA, and DCF of adjusted free cash flow.

Key drivers

i. Continued growth in international air traffic in China;
ii. Steady volume growth for its jet fuel supply business, which is based on a fixed cost-plus model;
iii. Steady growth in earnings from its associates, especially SPIA.

Key risks

i. Losses at its trading business, despite all the risk control measures;
ii. Opening up of the Chinese aviation fuel market, risking CAO's monopoly;
iii. Lower-than-estimated long term aviation traffic growth

Company Profile

China Aviation Oil supplies jet fuel to foreign and domestic airlines flying through Chinese and international airports. The company also trades in other oil products, such as fuel oil and gas oil. Its state-owned parent is the Asia-Pacific's largest physical jet fuel trader, and sole supplier of imported jet fuel for China's civil aviation market.

Financial summary (USD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring EPS	0.11	0.12	0.10	0.11	0.12
DPS	0.03	0.03	0.03	0.03	0.03
BVPS	0.89	0.96	1.03	1.11	1.20
Return on average equity (%)	12.6	12.4	10.2	10.5	10.5

Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring P/E (x)	6.36	5.98	6.77	6.14	5.71
P/B (x)	0.8	0.7	0.7	0.6	0.6
FCF Yield (%)	24.4	8.3	11.3	2.3	5.0
Dividend Yield (%)	4.8	4.7	4.9	4.9	4.9
EV/EBITDA (x)	8.23	4.65	3.56	2.83	1.22
EV/EBIT (x)	8.50	6.21	4.03	3.11	1.30

Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover	20,612	20,343	13,029	17,110	17,557
Gross profit	50	58	51	54	57
EBITDA	29	48	42	41	41
Depreciation and amortisation	(1)	(12)	(5)	(4)	(2)
Operating profit	28	36	37	37	39
Net interest	1	7	8	10	11
Pre-tax profit	101	106	94	104	112
Taxation	(7)	(7)	(6)	(7)	(7)
Reported net profit	94	100	88	97	105
Recurring net profit	94	100	88	97	105

Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Change in working capital	143	5	33	(18)	(2)
Cash flow from operations	146	50	68	14	30
Capex	(1)	(0)	(0)	(0)	(0)
Cash flow from investing activities	63	11	33	52	65
Dividends paid	(29)	(28)	(29)	(29)	(29)
Cash flow from financing activities	(152)	(41)	(30)	(30)	(30)
Cash at beginning of period	300	358	379	450	486
Net change in cash	57	20	71	36	65
Ending balance cash	358	379	450	486	551

Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total cash and equivalents	358	379	450	486	551
Tangible fixed assets	5	20	15	12	10
Total investments	311	362	387	404	414
Total assets	1,653	1,868	1,617	1,858	1,952
Total liabilities	884	1,033	724	896	915
Total equity	769	835	894	962	1,037
Total liabilities & equity	1,653	1,868	1,617	1,858	1,952

Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Revenue growth (%)	26.7	(1.3)	(36.0)	31.3	2.6
Recurrent EPS growth (%)	9.8	6.4	(11.6)	10.2	7.5
Gross margin (%)	0.2	0.3	0.4	0.3	0.3
Operating EBITDA margin (%)	0.1	0.2	0.3	0.2	0.2
Net profit margin (%)	0.5	0.5	0.7	0.6	0.6
Dividend payout ratio (%)	31.1	28.5	33.4	30.1	28.1
Capex/sales (%)	0.0	0.0	0.0	0.0	0.0
Interest cover (x)	9.06	39.92			

Source: Company data, RHB

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-01-21	Buy	1.55	1.27
2019-11-04	Buy	1.55	1.24
2019-09-02	Buy	1.50	1.14
2019-08-13	Buy	1.50	1.15
2019-08-07	Buy	1.60	1.23
2019-07-17	Buy	1.60	1.33
2019-07-10	Buy	1.60	1.30
2019-06-11	Buy	1.60	1.32
2019-05-28	Buy	1.60	1.26

Source: RHB, Bloomberg

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