

10 July 2019

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Buy (Maintained)

Chinese Aviation Traffic Continues To Grow

Target Price (Return) SGD1.60 (+23%)
Price: SGD1.30
Market Cap: USD821m
Avg Daily Turnover (SGD/USD) 1.25m/0.91m

- **BUY, SGD1.60 TP offers 23% upside, 3.5% yield.** Although CAO's share price has moved lower in line with jet fuel prices, we highlight that profitability of its China jet fuel business is driven by volumes and not so much by the oil price outlook. We remain upbeat on the long term growth of China's aviation passenger traffic, in line with its rising per capita income and expanding aviation infrastructure. We believe our earnings estimates remain conservative and ex-cash 4.3x 2020F P/E remains compelling.
- **China is witnessing strong growth in international passenger traffic.** This year, China's aviation passenger traffic registered 8.6% YoY growth, while its international aviation passenger traffic has grown 16.6% YoY. All international flights flying out of China are required to use imported jet fuel, which is supplied only by China Aviation Oil (CAO). Amidst expectation of some negative impact from the US-China trade war, we have conservatively forecasted mid single-digit jet fuel supply volume growth in 2019. This compares with an average volume growth of c.11% in the last 10 years.
- **SPA could see strong growth in traffic.** Shanghai Pudong International Airport Aviation Fuel Supply Company (SPIA, which is 33%-owned by CAO) is a refueller of jet fuel at Shanghai Pudong International Airport (SPA). SPA has witnessed average passenger traffic growth of 6% over the last eight quarters. The completion of capacity expansion by end-2019 could translate into a high growth rate in traffic at SPA and enable SPIA to register higher-than-estimated jet fuel volume growth in 2020-2021.
- **Oil price outlook does not impact profitability of its China jet fuel supply business.** During the last one year, CAO's share price has moved in tandem with jet fuel prices. While an outlook of weaker jet fuel price does limit CAO's ability to grow its trading volumes, it does not impact the profitability of its China jet fuel supply business, which has registered steady volume growth and earns a fixed USD per ton margin.
- **Large cash balance offers scope for inorganic growth.** CAO has been seeking opportunities to grow its jet fuel business outside China. A zero debt balance sheet and large net cash position (c.46% of its market cap), should enable CAO to undertake an earnings-accretive acquisition.
- **Reiterate BUY.** Despite outperforming the STI by 14% YTD, CAO's stock continues to trade at an FY20F P/E of 7.9x (ex-cash FY20F P/E of 4.3x). This compares with a conservative estimated FY20F earnings growth of 7.6%. The stock also remains cheap vs regional and global peers (Figure 5).
- **Key downside risks** are lower-than-estimated jet fuel volume growth and opening up of the Chinese aviation fuel supply market, which would put an end to CAO's current monopoly.

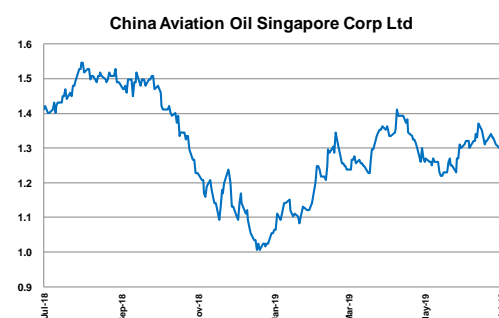
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Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------------------------|------|-------|-------|------|--------|
| Absolute | 22.6 | 0.0 | (7.8) | 18.2 | (11.0) |
| Relative | 14.1 | (5.2) | (7.9) | 12.8 | (14.1) |
| 52-wk Price low/high (SGD) | | | | 1.04 | 1.61 |



Source: Bloomberg

| Forecasts and Valuations | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
|---------------------------------|----------|----------|----------|----------|----------|
| Total turnover (USDm) | 16,268 | 20,612 | 17,595 | 18,324 | 17,746 |
| Recurring net profit (USDm) | 85 | 94 | 96 | 103 | 112 |
| Recurring net profit growth (%) | (3.9) | 9.8 | 2.4 | 7.6 | 8.2 |
| Recurring P/E (x) | 9.6 | 8.7 | 8.5 | 7.9 | 7.3 |
| P/BV (x) | 1.1 | 1.1 | 1.0 | 0.9 | 0.8 |
| P/CF (x) | nm | 5.6 | 10.6 | 47.9 | 29.2 |
| Dividend Yield (%) | 3.5 | 3.5 | 3.5 | 3.6 | 3.9 |
| EV/EBITDA (x) | 13.9 | 7.9 | 6.9 | 6.0 | 4.9 |
| ROE (%) | 12.4 | 12.6 | 11.9 | 11.8 | 11.7 |
| Net debt to equity (%) | net cash | net cash | net cash | net cash | net cash |
| Interest coverage (x) | 12.0 | 9.1 | 994.7 | nm | nm |

Source: Company data, RHB

10 July 2019

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Financial Exhibits

Financial model updated on: 10 June 2019

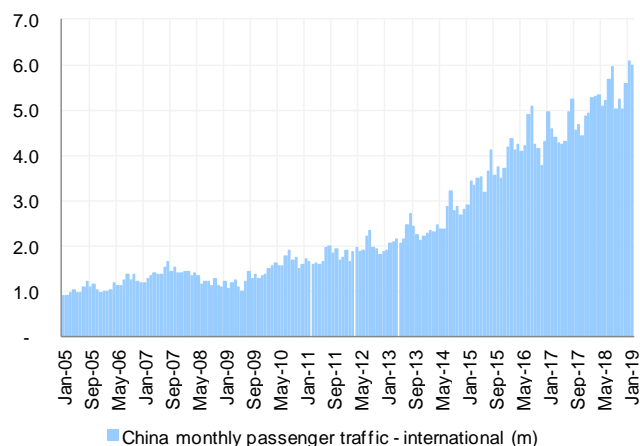
| Singapore | Financial summary | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
|--|-------------------------------------|--------|--------|--------|--------|--------|
| Energy | Recurring EPS (USD) | 0.10 | 0.11 | 0.11 | 0.12 | 0.13 |
| China Aviation Oil Singapore Corp Ltd | DPS (SGD) | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 |
| CAO SP Equity | BVPS (USD) | 0.84 | 0.89 | 0.97 | 1.05 | 1.15 |
| BUY | ROE (%) | 12.4 | 12.6 | 11.9 | 11.8 | 11.7 |
| Valuation basis | Valuation metrics | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
| Our TP is derived by using an average of forward P/E, P/BV, EV/adjusted EBITDA and DCF of adjusted free cash flow. | Recurring P/E (x) | 9.6 | 8.7 | 8.5 | 7.9 | 7.3 |
| | P/B (x) | 1.1 | 1.1 | 1.0 | 0.9 | 0.8 |
| | FCF Yield (%) | nm | 5.6 | 10.5 | 48.4 | 29.3 |
| | Dividend yield (%) | 3.5 | 3.5 | 3.5 | 3.6 | 3.9 |
| | EV/EBITDA (x) | 13.9 | 7.9 | 6.9 | 6.0 | 4.9 |
| | EV/EBIT (x) | 49.0 | 27.0 | 31.0 | 26.7 | 20.2 |
| Key drivers | Income statement (USDm) | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
| i. Continued growth in international air traffic in China; | Total turnover | 16,268 | 20,612 | 17,595 | 18,324 | 17,746 |
| ii. Steady volume growth for its jet fuel supply business, which is based on a fixed cost-plus model; | Gross profit | 39 | 50 | 46 | 48 | 50 |
| iii. Steady growth in earnings from its associates, especially the refueller at Shanghai Pudong International Airport. | EBITDA (adj.) | 68 | 97 | 94 | 96 | 102 |
| | Depreciation & amortisation | (1) | (1) | (1) | (1) | (1) |
| | Operating profit | 19 | 28 | 21 | 22 | 25 |
| | Net interest | 2 | 1 | 10 | 14 | 16 |
| | Pre-tax profit | 92 | 101 | 103 | 111 | 120 |
| | Taxation | (7) | (7) | (7) | (7) | (8) |
| | Net profit | 85 | 94 | 96 | 103 | 112 |
| | Recurring net profit | 85 | 94 | 96 | 103 | 112 |
| Key risks | Cash flow (USDm) | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
| i. Losses being reported at its oil trading business, despite all the risk control measures; | Change in working capital | (46) | 143 | 46 | (4) | 3 |
| ii. Opening up of the Chinese aviation fuel supply market, risking CAO's monopoly; | Cash flow from operations | (27) | 146 | 72 | 10 | 20 |
| iii. Higher-than-estimated growth of bonded jet fuel imports into China; | Capex | (0) | (1) | (0) | (0) | (0) |
| iv. Acquisition of an earnings-accretive business. | Cash flow from investing activities | 49 | 63 | 72 | 79 | 85 |
| | Dividends paid | (28) | (29) | (29) | (30) | (31) |
| | Cash flow from financing activities | (9) | (152) | (29) | (30) | (31) |
| | Cash at beginning of period | 287 | 300 | 358 | 478 | 544 |
| | Net change in cash | 13 | 58 | 115 | 60 | 74 |
| | Ending balance cash | 300 | 358 | 478 | 544 | 623 |
| Company Profile | Balance Sheet (USDm) | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
| China Aviation Oil Singapore Corp (CAO) 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 the sole supplier of imported jet fuel for China's civil aviation market. | Total cash and equivalents | 300 | 358 | 478 | 544 | 623 |
| | Tangible fixed assets | 5 | 5 | 5 | 4 | 4 |
| | Total investments | - | - | - | - | - |
| | Total assets | 1,913 | 1,653 | 1,779 | 1,887 | 1,940 |
| | Short-term debt | 120 | - | - | - | - |
| | Total long-term debt | - | - | - | - | - |
| | Total liabilities | 8 | 8 | 31 | 31 | 31 |
| | Total equity | 724 | 769 | 840 | 913 | 994 |
| | Total liabilities & equity | 1,913 | 1,653 | 1,779 | 1,887 | 1,940 |
| | Key metrics | Dec-17 | Dec-18 | Dec-19 | Dec-20 | Dec-21 |
| | Revenue growth (%) | 39.0 | 26.7 | (14.6) | 4.1 | (3.2) |
| | Recurrent EPS growth (%) | (4.3) | 10.8 | 2.6 | 8.3 | 9.0 |
| | Gross margin (%) | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| | Operating EBITDA margin (%) | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 |
| | Net profit margin (%) | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 |
| | Capex/sales (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | Interest cover (x) | 12.0 | 9.1 | 994.7 | nm | nm |

Source: RHB, Company data

10 July 2019

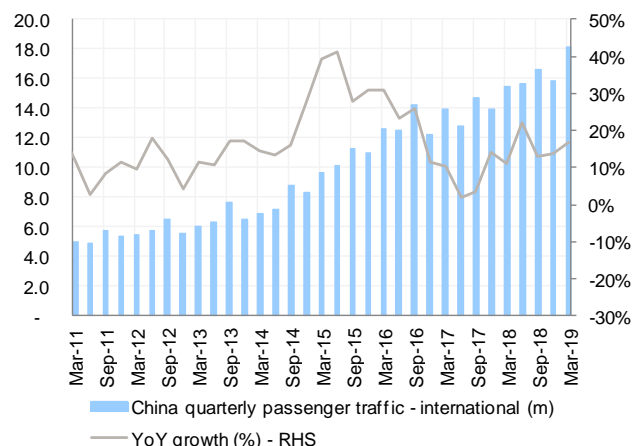
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Figure 1: International aviation passenger traffic in China



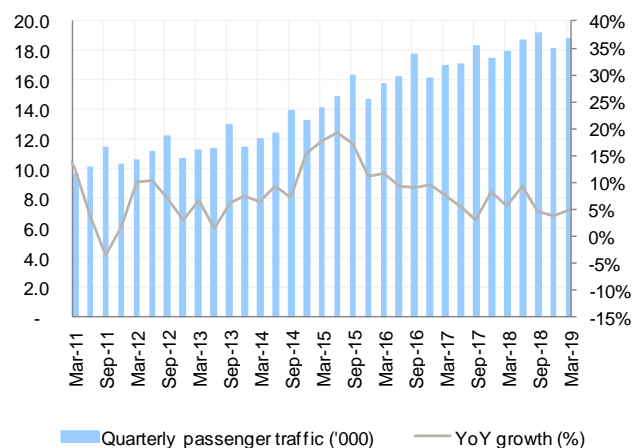
Source: CEIC

Figure 2: International aviation passenger traffic in China has grown at double digits in the last six quarters



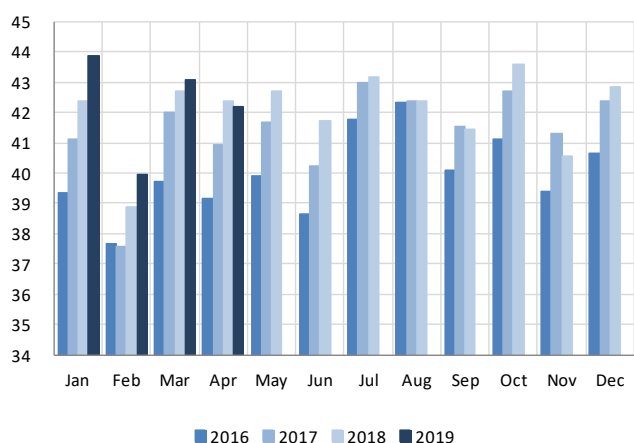
Source: CEIC

Figure 3: Passenger traffic at Shanghai Pudong Airport continues to grow



Source: CEIC

Figure 4: Monthly flights handled ('000) at Shanghai Pudong Airport registered strong growth in 2019



Source: CEIC

Figure 5: Peer comparison

| | BBG | Price | M Cap | Last | P/E | | | EV/EBITDA | | | P/BV | | | D Yield | ROE |
|--------------------------|-----------|-------|---------|--------|------|------|------|-----------|------|------|------|------|------|---------|-------|
| Company name | ticker | (LCY) | (USD m) | year | Last | 1FY | 2FY | Last | 1FY | 2FY | Last | 1FY | 2FY | 1FY | 1FY |
| Aviation jet fuel | | | | | | | | | | | | | | | |
| World Fuel Services | INT US | 35.86 | 2,412 | Dec-18 | 17.4 | 15.4 | 12.8 | 8.8 | 7.5 | 6.8 | - | 1.36 | - | 1.1% | 8.3% |
| BP | BP US | 41.08 | 139,584 | Dec-18 | 11.5 | 12.7 | 10.9 | 5.3 | 5.0 | 4.7 | 1.34 | 1.36 | 1.31 | 5.9% | 10.9% |
| Weighted average | | | 141,995 | | 11.6 | 12.7 | 11.0 | 5.3 | 5.1 | 4.7 | 1.32 | 1.36 | 1.28 | 5.9% | 10.9% |
| Airports - China | | | | | | | | | | | | | | | |
| Shanghai Airport | 600009 CH | 80.39 | 22,496 | Dec-18 | 36.6 | 29.4 | 27.7 | 27.2 | 21.4 | 19.0 | 5.48 | 4.78 | 4.22 | 1.0% | 16.7% |
| Beijing Capital | 694 HK | 6.79 | 3,765 | Dec-18 | 8.1 | 11.7 | 16.2 | 4.9 | 6.4 | 7.9 | 1.07 | 1.04 | 1.01 | 3.6% | 9.3% |
| Weighted average | | | 26,261 | | 32.5 | 26.9 | 26.0 | 24.0 | 19.2 | 17.4 | 4.85 | 4.24 | 3.76 | 1.4% | 15.6% |
| Weighted average of both | | | 168,257 | | 14.9 | 15.0 | 13.3 | 8.2 | 7.3 | 6.7 | 1.87 | 1.81 | 1.67 | 5.2% | 11.6% |
| | | | | | | | | | | | | | | | |
| China Aviation | CAO SP | 1.30 | 821 | Dec-18 | 8.8 | 8.5 | 7.9 | 4.8 | 5.0 | 4.8 | 1.08 | 0.99 | 0.91 | 4.7% | 11.9% |

Note: Prices as at 9 Jul 2019

Source: Bloomberg, RHB

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| | |
|---------------------|--|
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