

21 January 2020

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Buy (Maintained)

Remain Positive On Long-Term Growth; BUY

Target Price (Return) SGD1.55 (+21%)
Price: SGD1.28
Market Cap: USD818m
Avg Daily Turnover (SGD/USD) 0.57m/0.42m

• **Stay BUY and SGD1.55 TP, 21% upside plus c.4% yield.** We remain confident in China Aviation Oil's long-term growth. This should be aided by the continuing rise in China's aviation traffic and the group's diversification into jet fuel supply to non-Chinese markets. While weakness in associate earnings may persist in the near term, jet fuel refuelling volume growth at the Shanghai Pudong International Airport (SPA) could offer a positive surprise. Its ex-cash 6.4x 2020F P/E and below P/BV multiple remain compelling.

• **China is one of the key growth drivers; CAO is also diversifying away from its reliance on the East Asian state.** For the first 10 months of 2019, China's international aviation passenger traffic registered 17% YoY growth. All international flights flying out of the East Asian country are required to use imported jet fuel, which is supplied only by CAO. We have conservatively forecasted mid-single-digit jet fuel supply volume growth during 2019-2021. This compares with an average volume growth of c.11% over the last 10 years. Based on reported numbers, we estimate CAO registering growth in jet fuel supply volumes to regions outside China for three consecutive quarters during 9M19. This is in line with its efforts to diversify from its reliance on the Chinese aviation market.

• **SPA's new satellite terminal should support volume growth.** The recent addition of satellite terminals at SPA has increased the airport's annual passenger handling capacity to 80m passengers (SPA handled 74m passengers in 2018). Shanghai Pudong International Airport Aviation Fuel Supply (SPIA) – which is 33%-owned by CAO and accounts for c.65% of the latter's PBT – witnessed margins pressure in 2019 amidst weakening of the CNY against the USD. It was also due to the Government's decision to lower wholesale aviation fuel prices and rates charged by CAO's China National Aviation Fuel Group parent to the airlines. However, as the airport's sole refueller, we maintain that capacity addition at SPA could enable SPIA to register higher-than-estimated jet fuel volume growth in 2020-2021.

• **Reiterate BUY.** CAO's share price outperformed the STI Index by 19% in 2019. Despite that, it continues to trade at a low 8.5x 2020F P/E (ex-cash FY20F P/E of 6.4x). The stock also remains cheap vs regional and global peers, which are trading at 12.1-22.6x P/E (market cap weighted average of 13.7x). Given its zero debt balance sheet and significant net cash position (c.24% of its market cap), CAO should be able to undertake a sizable earnings-accretive acquisition.

Analyst

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.8	1.6	6.7	(3.0)	8.5
Relative	(0.7)	(0.3)	1.6	0.1	7.0
52-wk Price low/high (SGD)	1.11 - 1.47				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (USDm)	16,268	20,612	18,814	19,137	19,839
Recurring net profit (USDm)	85	94	94	97	103
Recurring net profit growth (%)	(3.9)	9.8	0.4	2.5	7.0
Recurring P/E (x)	9.6	8.7	8.7	8.5	7.9
P/BV (x)	1.1	1.1	1.0	0.9	0.9
P/CF (x)	nm	5.6	26.5	19.0	22.0
Dividend Yield (%)	3.5	3.5	3.5	3.6	3.9
EV/EBITDA (x)	13.6	7.8	7.1	6.2	5.5
ROE (%)	12.4	12.6	11.8	11.3	11.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Interest coverage (x)	12.0	9.1	68.4	nm	nm

Source: Company data, RHB

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Financial Exhibits

Singapore	Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Energy	Recurring EPS (USD)	0.10	0.11	0.11	0.11	0.12
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	0.95	1.03	1.12
BUY	ROE (%)	12.4	12.6	11.8	11.3	11.1
Valuation basis	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Our TP is derived from 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	8.7	8.5	7.9
	P/B (x)	1.1	1.1	1.0	0.9	0.9
	FCF Yield (%)	nm	5.6	26.7	19.0	22.0
	Dividend yield (%)	3.5	3.5	3.5	3.6	3.9
	EV/EBITDA (x)	13.6	7.8	7.1	6.2	5.5
	EV/EBIT (x)	48.1	26.4	22.0	17.9	15.2
Key drivers	Income statement (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
i. Continued growth in international air traffic in China;	Total turnover	16,268	20,612	18,814	19,137	19,839
ii. Steady volume growth for its jet fuel supply business, which is based on a fixed cost-plus model;	Gross profit	39	50	55	58	60
iii. Steady growth in earnings from its associates, especially SPIA.	EBITDA (adj.)	68	97	98	102	102
	Depreciation & amortisation	(1)	(1)	(1)	(1)	(1)
	Operating profit	19	28	32	35	37
	Net interest	2	1	6	8	9
	Pre-tax profit	92	101	101	103	111
	Taxation	(7)	(7)	(6)	(7)	(7)
	Net profit	85	94	94	97	103
	Recurring net profit	85	94	94	97	103
Key risks	Cash flow (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
i. Losses at its trading business, despite all the risk control measures;	Change in working capital	(46)	143	(25)	(3)	(5)
ii. Opening up of the Chinese aviation fuel market, risking CAO's monopoly;	Cash flow from operations	(27)	146	30	37	30
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	57	62	67
	Dividends paid	(28)	(29)	(28)	(28)	(29)
	Cash flow from financing activities	(9)	(152)	(29)	(28)	(29)
	Cash at beginning of period	287	300	358	408	478
	Net change in cash	13	58	59	70	68
	Ending balance cash	300	358	408	478	546
Company Profile	Balance Sheet (USDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
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 sole supplier of imported jet fuel for China's civil aviation market.	Total cash and equivalents	300	358	408	478	546
	Tangible fixed assets	5	5	5	4	4
	Total investments	-	-	-	-	-
	Total assets	1,913	1,653	1,833	1,920	2,031
	Short-term debt	120	-	-	-	-
	Total long-term debt	-	-	-	-	-
	Total liabilities	8	8	29	30	31
	Total equity	724	769	824	893	968
	Total liabilities & equity	1,913	1,653	1,833	1,920	2,031
	Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	39.0	26.7	(8.7)	1.7	3.7
	Recurrent EPS growth (%)	(4.3)	10.8	0.5	2.8	7.7
	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	0.5	0.5
	Capex/sales (%)	0.0	0.0	0.0	0.0	0.0
	Interest cover (x)	12.0	9.1	68.4	nm	nm

Source: RHB, Company data

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