

4 November 2019

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Buy (Maintained)

Strong 3Q19 Results; Reiterate BUY

Target Price (Return) SGD1.55 (+26%)
Price: SGD1.23
Market Cap: USD779m
Avg Daily Turnover (SGD/USD) 0.64m/0.47m

- **Maintain BUY with new SGD1.55 TP from SGD1.50, 26% upside plus c.4% yield.** Better-than-expected 3Q19 earnings were driven by an increase in volume and profitability for the supply of jet fuel in regions outside China. This more than offset weakness in earnings contribution from associates. While weakness in associate earnings may persist in the near term, we remain confident of CAO's long-term growth – to be driven by growth in Chinese aviation traffic. Ex-cash 6x 2020F P/E and below 1x P/BV remains compelling.
- **3Q19 results beat expectations.** Amidst 19% growth in middle distillate volumes and increase in profitability for supply of jet fuel to regions outside China, China Aviation Oil (CAO) reported gross profit of USD16.3m, which was almost double of our gross profit estimate of USD8.6m. However, weak contribution from associates, which was due to a decline in earnings for Shanghai Pudong International Airport Aviation Fuel Supply Corp Ltd (SPIA, 33%-owned by CAO), implied that reported PATMI of USD23.9m was only 19% higher than our estimated PATMI of USD20.1m.
- **CAO continues to grow jet fuel volume and profits.** We estimate that CAO reported growth in jet fuel supply volume to regions outside China for a third consecutive quarter. This is in line with CAO's efforts to diversify from its reliance on the Chinese aviation market. We also estimate that volume for supply of jet fuel in China declined for the first time since 3Q17. Nevertheless, jet fuel supply and trading business remain highly profitable as we estimate that gross profit generated from the supply of jet fuel to regions outside China almost tripled from the same quarter last year.
- **Lower margins to offset near term volume growth for SPIA.** Although SPIA reported 5% increase in volume, profit fell 30% due to the weakening of the CNY against the USD, and due to pressure on margins driven by the Government's decision to lower wholesale aviation fuel prices and rates charged by China National Aviation Fuel Group (CAO's parent) to the airlines ([news article](#)). The decision was taken to boost aviation traffic in China. While the recent increase in Shanghai Pudong Airport's passenger capacity should drive strong growth in jet fuel refuelling volume, near term earnings growth may be hampered by lower margins.
- **Reiterate BUY.** We reduce CAO's 2020F-2021F by 3% to account for lower crude oil price forecasts and lower contribution from SPIA. CAO's valuation remains cheap vs regional and global peers. Given its zero debt balance sheet and significant net cash position (c.25% of its market cap) it is expected to undertake a sizable earnings-accretive acquisition.

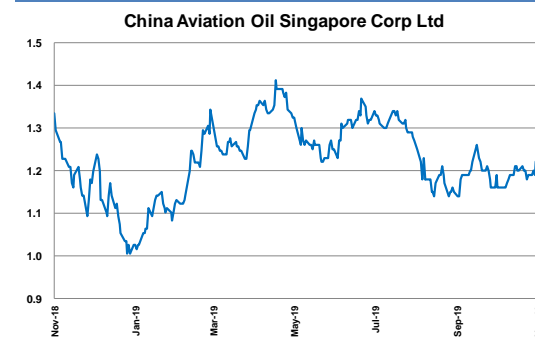
Analyst

Shekhar Jaiswal
+65 6232 3894
shekhar.jaiswal@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	16.0	3.4	(2.4)	(10.2)	(10.9)
Relative	10.8	0.7	(0.5)	(5.2)	(16.4)
52-wk Price low/high (SGD)					1.04 - 1.59



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)	9.1	8.3	8.3	8.1	7.5
P/BV (x)	1.1	1.0	1.0	0.9	0.8
P/CF (x)	nm	5.3	25.2	18.1	21.0
Dividend Yield (%)	3.7	3.7	3.7	3.8	4.0
EV/EBITDA (x)	13.0	7.3	6.7	5.8	5.1
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)	9.1	8.3	8.3	8.1	7.5
	P/B (x)	1.1	1.0	1.0	0.9	0.8
	FCF Yield (%)	nm	5.3	25.4	18.1	21.0
	Dividend yield (%)	3.7	3.7	3.7	3.8	4.0
	EV/EBITDA (x)	13.0	7.3	6.7	5.8	5.1
	EV/EBIT (x)	45.8	24.8	20.6	16.7	14.0
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
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	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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Results Review

Figure 1: CAO's 3Q19 results review

(USDm)		4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	QoQ%	YoY%	9H18	9H19	YoY%
Income statement														
Revenue		4,061	4,102	5,800	6,332	4,377	3,718	5,965	5,559	-7%	-12%	16,235	15,242	-6%
Cost of sales		(4,052)	(4,089)	(5,784)	(6,321)	(4,368)	(3,706)	(5,948)	(5,542)	-7%	-12%	(16,194)	(15,197)	-6%
Gross Profit		8.3	13.2	16.4	11.1	9.3	11.6	17.1	16.3	-5%	47%	40.7	45.0	11%
Other operating income		0.0	(0.1)	0.3	(0.8)	(0.0)	(0.1)	(0.1)	(0.2)	110%	-73%	(0.6)	(0.5)	-15%
Administrative expenses		(5.0)	(3.9)	(3.8)	(3.7)	(7.6)	(3.2)	(2.7)	(4.1)	53%	10%	(11.4)	(10.0)	-13%
Other operating expenses		(1.1)	(2.2)	(1.4)	(2.1)	3.9	(2.0)	(4.6)	1.0	-121%	-145%	(5.7)	(5.6)	-2%
Operating Profit		2.2	7.1	11.5	4.4	5.6	6.3	9.7	12.9	33%	195%	22.9	28.9	26%
Finance costs (net)		(0.4)	0.5	0.2	(1.5)	0.7	2.1	1.2	0.6	-54%	-139%	(0.8)	3.9	-594%
Associates and JVs		16.8	21.0	18.6	17.5	15.0	19.1	19.2	12.6	-34%	-28%	57.1	50.9	-11%
Profit before tax		18.6	28.5	30.3	20.4	21.3	27.5	30.1	26.1	-13%	28%	79.2	83.6	6%
Income tax		(3.3)	(1.6)	(1.0)	(1.5)	(2.6)	(1.1)	(1.6)	(2.2)	34%	48%	(4.1)	(5.0)	22%
Profit after tax		15.3	26.9	29.3	18.9	18.7	26.3	28.5	23.9	-16%	26%	75.1	78.6	5%
Minority Interest		-	-	-	-	-	-	-	-	0%	0%	-	-	0%
PATMI (recurring)		15.8	26.9	29.3	18.9	18.7	26.3	28.5	23.9	-16%	26%	75.1	78.6	5%
Depreciation & amortisation		(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)	2%	13%	(0.7)	(0.8)	16%
EBITDA		2.4	7.3	11.7	4.6	5.8	9.0	12.7	15.9	25%	245%	23.6	37.6	59%
Margins														
Gross margin	%	0.21%	0.32%	0.28%	0.17%	0.21%	0.31%	0.29%	0.29%			0.25%	0.30%	
Operating margin	%	0.05%	0.17%	0.20%	0.07%	0.13%	0.17%	0.16%	0.23%			0.14%	0.19%	
EBITDA margin	%	0.06%	0.18%	0.20%	0.07%	0.13%	0.24%	0.21%	0.29%			0.15%	0.25%	
Net margin	%	0.39%	0.66%	0.51%	0.30%	0.43%	0.71%	0.48%	0.43%			0.46%	0.52%	
Segment revenue														
Middle distillates		2,779	2,679	3,118	3,580	2,985	2,757	3,638	3,699	2%	3%	9,377	10,094	8%
Other oil products		1,282	1,423	2,682	2,752	1,392	961	2,328	1,859	-20%	-32%	6,858	5,148	-25%
Segment volume														
Middle distillates	m tonnes	5.1	4.3	4.6	5.1	4.3	4.6	5.7	6.1	7%	19%	14.0	16.5	18%
Other oil products	m tonnes	3.1	3.3	5.4	5.3	2.6	2.1	4.9	4.2	-14%	-21%	14.1	11.3	-20%

Source: Company data, RHB

Figure 2: Peer comparison

	BBG	Price	M Cap	Last	P/E			EV/EBITDA			P/BV			D Yield	ROE	N.Margin
Company name	ticker	(LCY)	(USD m)	year	Last	1FY	2FY	Last	1FY	2FY	Last	1FY	2FY	1FY	1FY	1FY
Aviation jet fuel																
World Fuel Services	INT US	41.77	2,731	Dec-18	20.3	17.5	14.4	9.1	7.9	7.1	-	-	-	0.9%	8.8%	0.4%
BP	BP US	37.91	128,467	Dec-18	10.7	12.9	11.1	5.0	5.0	4.7	1.24	1.28	1.24	6.5%	9.9%	3.6%
Weighted average			131,198		10.9	13.0	11.2	5.1	5.1	4.7	1.21	1.25	1.21	6.4%	9.9%	3.5%
Airports - China																
Shanghai Airport	600009 CH	76.26	20,884	Dec-18	34.7	27.8	25.3	25.5	20.3	17.8	5.20	4.55	4.01	1.1%	16.9%	45.9%
Beijing Capital	694 HK	7.35	4,061	Dec-18	8.7	13.0	17.8	5.0	6.6	8.3	1.16	1.16	1.11	3.2%	9.2%	21.0%
Weighted average			24,945		30.5	25.4	24.1	22.2	18.1	16.2	4.54	4.00	3.54	1.4%	15.6%	41.9%
Weighted average of both			156,143		14.0	14.9	13.3	7.8	7.2	6.6	1.75	1.69	1.58	5.6%	10.8%	9.6%
China Aviation	CAO SP	1.23	779	Dec-18	8.3	8.3	8.1	6.1	6.0	5.8	1.02	0.95	0.88	3.7%	11.8%	0.5%

Note: Prices as at 1 Nov 2019

Source: Bloomberg, RHB

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KUALA LUMPUR

RHB Investment Bank Bhd

Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia

Revenue Tower 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

HONG KONG

RHB Securities Hong Kong Ltd.

12th Floor, World-Wide House
19 Des Voeux Road
Central
Hong Kong
Tel : +852 2525 1118
Fax : +852 2810 0908

BANGKOK

RHB Securities (Thailand) PCL

10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Securities Singapore Pte Ltd.

10 Collyer Quay
#09-08 Ocean Financial Centre
Singapore 049315
Tel : +65 6533 1818
Fax : +65 6532 6211