

21 November 2018

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil

Neutral (Maintained)

Ground Checks: More Headwinds

Maintain NEUTRAL with a new SGD1.32 TP from SGD1.50, 8% upside and 5% FY19F yield. A recent meeting with CAO confirmed our concerns about seasonally weak earnings, and likely slowdown in trading volumes for crude oil and jet fuel in 4Q18. We believe the market remains anxious about the potential business impact from recent change in its CEO and some board members. Concerns regarding the profitability of the recently-acquired European business and SPIA's declining profit margins should also keep investors at bay, at least in the near term.

4Q will be a seasonally weak quarter. With the exception of 2012, China Aviation Oil has reported its lowest quarterly profit in 4Q every year since 2011. Our recent meeting with management confirmed that 2018 will not be any different. Amidst volatile oil prices, CAO is likely to stay in risk-off mode for its trading business. We expect the company to report USD16.7m in profit (+3% YoY) in 4Q18, which will be the lowest quarterly profit for 2018.

European acquisition could struggle to grow in the near term. CAO acquired Navires Aviation (NAL) in June to establish an into-wing jet fuel supply system at four European airports: Schiphol, Brussels, Frankfurt and Stuttgart. However, a drought that has hit Europe's Rhine River has choked off fuel flows into inland Europe (see [news report](#)). In October, Germany had to release oil products from its national reserves to help states affected by tight supplies due to logistics hiccups caused by low river water levels (see [news report](#)). While the NAL acquisition was not expected to have material contributions to CAO's 2018 bottomline, we believe any growth in volumes and profit in the near term will now be difficult to achieve.

Recent change in management brings uncertainty. In September, CAO announced the appointment of Wang Yanjun as its new CEO, replacing Meng Fanqiu who had spearheaded its turnaround over the last 10 years. Wang was CAO's vice president during Sep 2017-Feb 2018 and is currently CAO (Hong Kong)'s director & vice president. The company also announced some changes to its board on 1 Nov 2018, the same day it announced weak quarterly results (3Q18 profit fell 12% YoY). With change comes uncertainty, and we believe the market awaits updates from CAO to get a better understanding of whether there will be any changes in business direction under the new CEO and board.

Maintain NEUTRAL with a new SGD1.32 TP. With expectations of weak 4Q18 results, negligible growth in 2019, concerns related to changes in business direction with new CEO and board now in place, and forward oil price staying in backwardation, we believe CAO's share price will continue to face more headwinds than tailwinds in the near term. We have lowered 2018F-2020F earnings 2-6% and reduced our blended TP.

Key risks. While 5% FY19F yield could provide downside protection to CAO's share price, any material re-rating would require strong recovery in earnings growth, an earnings accretive acquisition, and higher jet fuel volumes at Shanghai Pudong International Airport Aviation Fuel Supply (SPIA).

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (USDm)	11,703.2	16,267.6	20,288.7	16,895.7	17,189.2
Reported net profit (USDm)	88.9	85.3	91.9	93.1	98.2
Recurring net profit (USDm)	88.9	85.9	91.9	93.1	98.2
Recurring net profit growth (%)	45.1	(3.4)	7.0	1.3	5.4
Recurring EPS (USD)	0.10	0.10	0.11	0.11	0.11
DPS (USD)	0.04	0.05	0.04	0.04	0.05
Recurring P/E (x)	8.6	8.9	8.3	8.2	7.8
P/B (x)	1.2	1.1	1.0	0.9	0.9
P/CF (x)	na	na	12.0	37.0	118.7
Dividend Yield (%)	5.0	5.1	4.9	4.9	5.1
EV/EBITDA (x)	9.0	8.6	7.3	6.5	5.9
Return on average equity (%)	14.3	12.5	12.3	11.7	11.3
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Our vs. consensus EPS (adjusted) (%)					

Source: Company data, RHB

Target Price: SGD1.32
Price: SGD1.22
Market Cap: USD765
Bloomberg Ticker: CAO SP

Share Data

Avg Daily Turnover (SGD/USD)	0.52m/0.38m
52-wk Price low/high (SGD)	1.71 - 1.20
Free Float (%)	28.5
Shares outstanding (m)	860
Estimated Return	8%

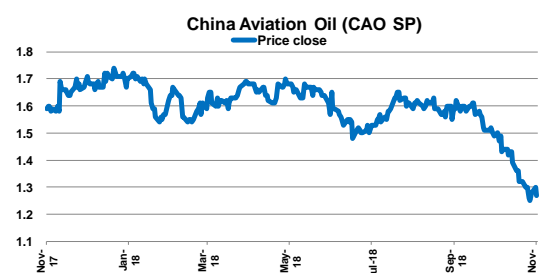
Shareholders (%)

China National Aviation Fuel	51.3
BP	20.2
Mathews International	1.6

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(24.7)	(15.3)	(20.8)	(25.2)	(20.8)
Relative	(13.6)	(14.1)	(15.2)	(10.9)	(10.2)

Source: Bloomberg



Source: Bloomberg

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