

21 March 2022

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Neutral (Maintained)

Uncertainty Prevails

Target Price (Return): SGD1.00 (12.4%)
 Price (Market Cap): SGD0.89 (USD561m)
 ESG score: 2.67 (out of 4)
 Avg Daily Turnover (SGD/USD) 0.17m/0.13m

- **Still NEUTRAL and SGD1.00 TP, 12% upside.** The recent increase in China's COVID-19 cases – and resultant lockdown – continues to be negative for recovery in the country's domestic and international aviation traffic. Last Friday, China's National Health Commission (NHC) reiterated the significance of the country firmly sticking to its zero COVID-19 policy. While there has been some easing of COVID-19 guidelines, we believe the uncertainty over China Aviation Oil's earnings recovery will overshadow its compelling valuation.
- **Some glimmer of hope; too early to pull the trigger.** Based on a [Straits Times news report](#), it seems China may be preparing for the next stage of COVID-19 disease management as the country's NHC – in its updated guidelines – announced patients with mild symptoms no longer need to be hospitalised; they can instead go into centralised quarantine facilities. Those that recovered from COVID-19 will now need to do only seven days of home monitoring rather than a hard 14-day quarantine as previously mandated. The authorities also allowed the sale of rapid antigen test kits, augmenting the labour-intensive nucleic acid testing regime. We believe the move will ease the pressure on China's healthcare system and could also mean the country is bracing itself for more, but milder, infections.
- **China reiterates the importance of zero COVID-19 policy.** As per [news reports](#) from last week, China had put >45m people under some form of lockdown as authorities sought to stamp out the country's biggest pandemic spread in more than two years. Last Friday, the NHC [reiterated](#) the significance of China sticking firmly to the dynamic zero COVID-19 policy, saying that the defensive line against the pandemic must be guarded for its 1.4bn people. This has already started showing an impact on China's aviation traffic, with domestic, international, and commercial aviation numbers at Shanghai Pudong International Airport (SPIA) trending lower YoY for the 12-19 Mar period (Figures 1, 2, and 3).
- **No clear re-rating catalysts despite low valuation.** From a low base of 2021, we expect CAO to report a 28% YoY profit growth each in 2022-2023. Its 2022F P/E is at 11x, implying an exciting 0.4x 2022F PEG. However, the uncertainty around CAO being able to deliver such earnings growth remains elevated. The company has been holding on to a net cash position (69% of its market cap) for a long while now and has failed to deliver any inorganic growth. We apply a 6% ESG discount to our fair value of SGD1.06 to arrive at a SGD1.00 TP. NEUTRAL. Upside risks: Earlier than expected easing of China's zero COVID-19 policy and strong revival in its international aviation traffic. Downside risks: China retains zero COVID-19 throughout 2022, reduction in margins earned by SPIA, and lower-than-expected margins for the trading business.

Analyst

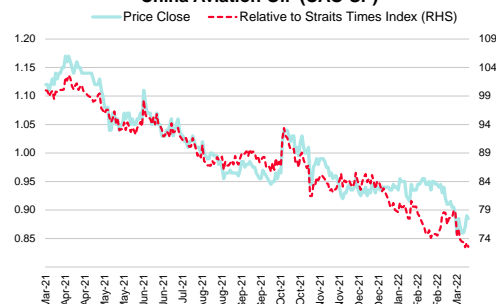
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(5.9)	(6.4)	(5.4)	(8.3)	(21.7)
Relative	(12.5)	(3.5)	(12.4)	(16.7)	(27.9)
52-wk Price low/high (SGD)	0.86 – 1.17				

China Aviation Oil (CAO SP)



Source: Bloomberg

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	10,517	17,637	25,478	22,179	18,742
Recurring net profit (USDm)	56	40	52	66	78
Recurring net profit growth (%)	(43.7)	(28.2)	28.7	27.4	18.1
Recurring P/E (x)	9.98	13.90	10.81	8.48	7.18
P/B (x)	0.6	0.6	0.6	0.6	0.5
P/CF (x)	na	4.96	4.35	15.95	13.74
Dividend Yield (%)	5.1	3.0	2.1	2.8	3.5
EV/EBITDA (x)	6.67	5.65	0.83	(1.46)	(3.15)
Return on average equity (%)	6.6	4.5	5.6	6.8	7.7
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Overall ESG Score: 2.67 (out of 4)

E: GOOD

CAO complies with relevant laws and regulations to avoid any potential non-compliance incidents, and strives to minimise and mitigate the impact of potential oil spills to protect the surrounding environment. However, given its exposure to oil and jet fuel, CAO scores relatively low on our Environmental pillar.

S: GOOD

As human capital is a valuable advantage and the very foundation of CAO's business, it supports the health and well-being of its employees by upholding an inclusive and diverse culture. Amidst COVID-19, it offered expanded medical benefits and insurance coverage to employees. Women make up 50% of its employee base.

G: GOOD

CAO's board has nine directors, of which four (44%) are independent and only one (c.10%) is a woman. It was awarded the Most Transparent Company (in Energy Category) by SIAS in 2019.

21 March 2022

Energy & Petrochemicals | Oil & Gas Services

Financial Exhibits

Asia	Financial summary (USD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS	0.07	0.05	0.06	0.08	0.09
Energy & Petrochemicals	DPS	0.03	0.02	0.01	0.02	0.02
China Aviation Oil	BVPS	1.01	1.04	1.09	1.14	1.21
CAO SP	Return on average equity (%)	6.6	4.5	5.6	6.8	7.7
Neutral						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Recurring P/E (x)	9.98	13.90	10.81	8.48	7.18
	P/B (x)	0.6	0.6	0.6	0.6	0.5
	FCF Yield (%)	(29.7)	20.1	22.9	6.2	7.2
	Dividend Yield (%)	5.1	3.0	2.1	2.8	3.5
	EV/EBITDA (x)	6.67	5.65	0.83	(1.46)	(3.15)
	EV/EBIT (x)	9.18	8.44	0.99	(1.65)	(3.49)
Valuation basis	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Our TP is derived from an average of forward P/E, P/BV, EV/adjusted EBITDA, and DCF of adjusted free cash flow.	Total turnover	10,517	17,637	25,478	22,179	18,742
	Gross profit	46	31	41	45	48
	EBITDA	44	29	20	27	33
	Depreciation and amortisation	(12)	(10)	(3)	(3)	(3)
	Operating profit	32	19	17	24	30
	Net interest	5	3	5	7	7
	Pre-tax profit	60	44	56	71	84
	Taxation	(4)	(4)	(4)	(5)	(5)
	Reported net profit	56	40	52	66	78
	Recurring net profit	56	40	52	66	78
Key drivers	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Revival of international air traffic growth in China;	Change in working capital	(228)	96	114	14	14
ii. Steady volume growth for its jet fuel supply business in China and overseas as well;	Cash flow from operations	(166)	113	129	35	41
iii. Growth in earnings from its associates, especially Shanghai Pudong International Airport or SPIA.	Capex	(0)	(0)	(0)	(0)	(0)
	Cash flow from investing activities	97	44	31	37	44
	Dividends paid	(29)	(17)	(12)	(16)	(20)
	Cash flow from financing activities	(40)	(25)	(12)	(16)	(20)
	Cash at beginning of period	379	269	401	548	605
	Net change in cash	(110)	132	148	57	64
	Ending balance cash	269	401	548	605	670
Key risks	Balance sheet (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Upside risks:	Total cash and equivalents	269	401	548	605	670
i. Earlier than expected easing of China's zero COVID-19 policy;	Tangible fixed assets	9	18	15	12	10
ii. Strong revival in China's international aviation traffic.	Total investments	305	284	293	303	313
	Total assets	1,888	1,536	2,101	2,005	1,910
	Total liabilities	1,011	634	1,160	1,013	860
	Total equity	877	901	941	992	1,050
	Total liabilities & equity	1,888	1,536	2,101	2,005	1,910
Downside risks:	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. China retains the zero COVID-19 policy throughout 2022;	Revenue growth (%)	(48.3)	67.7	44.5	(12.9)	(15.5)
ii. A reduction in margins earned by SPIA;	Recurrent EPS growth (%)	(43.7)	(28.2)	28.7	27.4	18.1
iii. Lower-than-expected margins for CAO's trading business.	Gross margin (%)	0.4	0.2	0.2	0.2	0.3
	Operating EBITDA margin (%)	0.4	0.2	0.1	0.1	0.2
	Net profit margin (%)	0.5	0.2	0.2	0.3	0.4
	Dividend payout ratio (%)	51.3	41.5	23.1	23.9	25.6
	Capex/sales (%)	0.0	0.0	0.0	0.0	0.0
	Interest cover (x)	356				
Company Profile						
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.						

Source: Company data, RHB

21 March 2022

Energy & Petrochemicals | Oil & Gas Services

Figure 1: Domestic flights in China (7-day average)



Source: RadarBox.com

Figure 2: International flights in China (7-day average)



Source: RadarBox.com

Figure 3: Commercial aircraft movement at SPIA (7-day average)

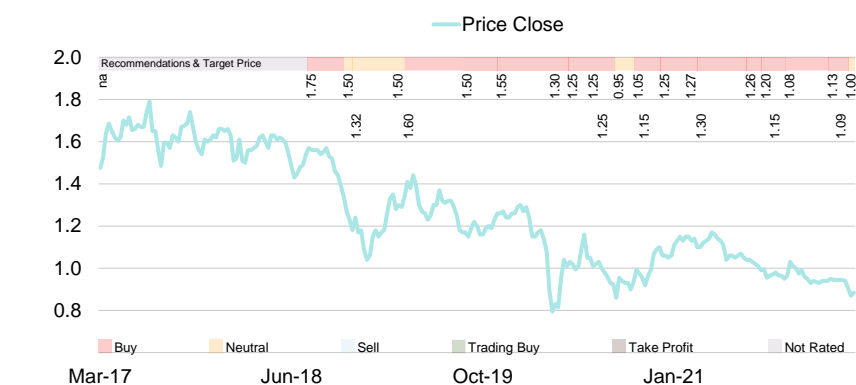


Source: RadarBox.com

21 March 2022

Energy & Petrochemicals | Oil & Gas Services

Recommendation Chart

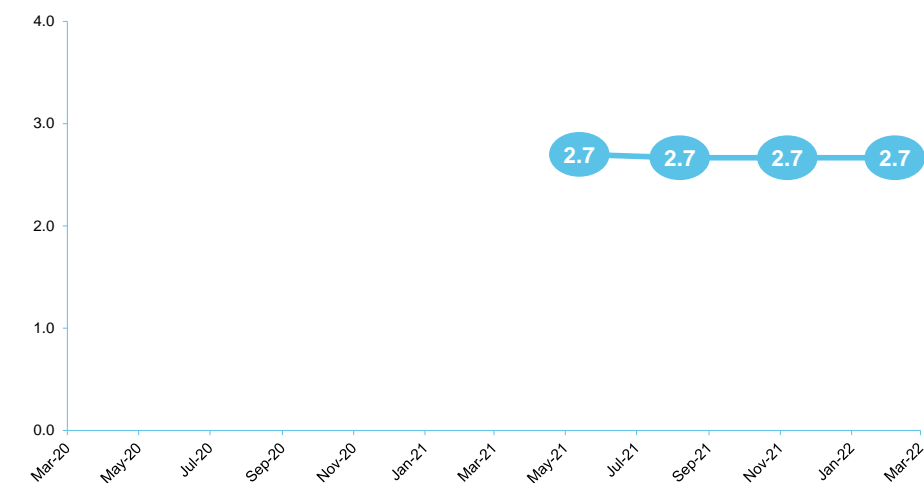


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-03-02	Neutral	1.00	0.91
2022-02-02	Buy	1.09	0.94
2022-01-12	Buy	1.13	0.94
2021-10-01	Buy	1.08	0.95
2021-08-26	Buy	1.15	0.97
2021-08-04	Buy	1.20	1.00
2021-06-28	Buy	1.26	1.05
2021-03-01	Buy	1.30	1.12
2021-02-04	Buy	1.27	1.16
2020-12-02	Buy	1.25	1.06
2020-10-14	Buy	1.15	1.00
2020-09-30	Buy	1.05	0.93
2020-08-13	Neutral	0.95	0.94
2020-06-12	Buy	1.25	1.05

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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