

13 August 2020

Energy & Petrochemicals | Oil & Gas Services

China Aviation Oil (CAO SP)

Neutral (from Buy)

Aviation Traffic Recovery Delayed; Now NEUTRAL

Target Price (Return): SGD0.95 (2.2%)
Price: SGD0.93
Market Cap: USD582m
Avg Daily Turnover (SGD/USD) 0.57m/0.41m

- **Downgrade to NEUTRAL, with SGD0.95 TP from SGD1.25, 2% upside and 3% 2021F yield.** We lower 2020F-2022F profit by 26%-27% to account for a delay in China's aviation traffic recovery. While China's domestic aviation traffic continues to register MoM improvement, the resurgence of COVID-19 infections will push international traffic recovery to 2021. This would impact earnings for Shanghai Pudong International Airport Aviation Fuel Supply (SPIA), which accounted for 65% of China Aviation Oil's 2019 PBT. While valuations remain compelling, we now prefer to wait for clear signs of traffic recovery.
- **Aviation traffic in China continues to improve sequentially.** Although China is still witnessing YoY decline in passenger aviation traffic, it has seen a sharp MoM passenger traffic revival since the low of Feb 2020. Amidst COVID-19, China's passenger aviation traffic had declined to 8.3m in February from 50.6m in January. Since February, passenger aviation traffic has improved each month, reaching 36.9m in July. Much of this improvement has been driven by the revival in domestic air travel.
- **International aviation traffic recovery to be delayed.** SPIA, the exclusive aircraft refuelling service provider at Shanghai Pudong Airport (SPA), is CAO's 33%-owned associate. At SPA, domestic aircraft movements have increased to c.16k in June from the low of c.7k in February. This compares with an average monthly domestic aircraft movement of c.22k in 2019. For international traffic, aircraft movement has remained unchanged since February, at c.7k vs a c17k monthly average in 2019. We note that the average number of passengers per international flight at SPA in 2Q20 was less than 10, implying near-term downside risks to international aircraft movements at SPA.
- **Strong cash position.** CAO received USD59.7m of dividends from SPIA in 1H20, paid in arrears from last year's earnings. Thanks to this, and positive FCF generation in 1H20, CAO's net cash position stands at USD406.7m, accounting for c.70% of its market cap. We had highlighted in an earlier [report](#) that CAO's parent plans to expand its global presence in next few years. For this purpose, China National Aviation Fuel plans to leverage on CAO's international presence. We maintain that CAO could use its large cash balance for an earnings accretive acquisition, should an opportunity arise.
- **Compelling valuations; waiting for signs of traffic recovery.** Although CAO's 2021F 8.5x P/E is below the range of multiples of its global jet fuel-supplying peers, and implies only 0.3x 2021F PEG, the likely delay in international aviation traffic recovery – due to the resurgence of COVID-19 infections – has increased downside risks to near-term earnings.

Analyst

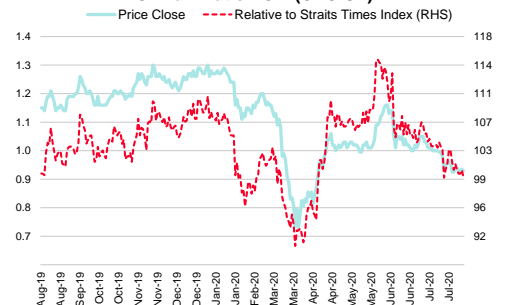
Shekhar Jaiswal
+65 6232 3894
shekhar.jaiswal@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(26.8)	(9.7)	(8.8)	(19.8)	(21.2)
Relative	(6.3)	(6.3)	(7.8)	0.7	(2.1)
52-wk Price low/high (SGD)	0.73 – 1.30				

China Aviation Oil (CAO SP)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	20,612	20,343	9,970	14,366	15,019
Recurring net profit (USDm)	94	100	52	68	73
Recurring net profit growth (%)	9.8	6.4	(47.7)	30.6	7.2
Recurring P/E (x)	6.21	5.83	11.15	8.54	7.96
P/B (x)	0.8	0.7	0.7	0.6	0.6
P/CF (x)	3.98	11.68	7.54	37.56	17.62
Dividend Yield (%)	5.0	4.9	5.1	3.0	3.6
EV/EBITDA (x)	7.72	4.34	2.54	1.52	0.43
Return on average equity (%)	12.6	12.4	6.2	7.7	7.8
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

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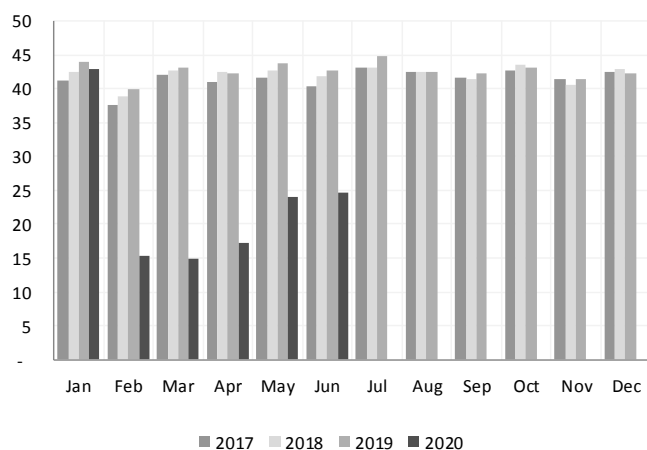
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Financial Exhibits

Asia	Financial summary (USD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.11	0.12	0.06	0.08	0.09
Energy & Petrochemicals	DPS	0.03	0.03	0.03	0.02	0.02
China Aviation Oil	BVPS	0.89	0.96	0.99	1.05	1.11
CAO SP	Return on average equity (%)	12.6	12.4	6.2	7.7	7.8
Neutral						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	6.21	5.83	11.15	8.54	7.96
Our TP is derived from an average of forward P/E, P/BV, EV/adjusted EBITDA, and DCF of adjusted free cash flow.	P/B (x)	0.8	0.7	0.7	0.6	0.6
	FCF Yield (%)	25.0	8.5	13.2	2.6	5.6
	Dividend Yield (%)	5.0	4.9	5.1	3.0	3.6
Key drivers	EV/EBITDA (x)	7.72	4.34	2.54	1.52	0.43
i. Revival of international air traffic growth in China;	EV/EBIT (x)	7.97	5.79	2.95	1.66	0.46
ii. Steady volume growth for its jet fuel supply business in China and overseas;						
iii. Growth in earnings from its associates, especially SPIA.						
	Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key risks	Total turnover	20,612	20,343	9,970	14,366	15,019
i. Losses at its trading business, despite all the risk control measures;	Gross profit	50	58	40	52	55
ii. Opening up of the Chinese aviation fuel market, risking CAO's monopoly;	EBITDA	29	48	35	42	43
iii. Lower-than-estimated aviation traffic growth.	Depreciation and amortisation	(1)	(12)	(5)	(4)	(2)
	Operating profit	28	36	30	38	40
	Net interest	1	7	8	11	12
	Pre-tax profit	101	106	56	73	78
	Taxation	(7)	(7)	(4)	(5)	(5)
	Reported net profit	94	100	52	68	73
	Recurring net profit	94	100	52	68	73
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 Asia-Pacific's largest physical jet fuel trader and sole supplier of imported jet fuel for China's civil aviation market.	Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	143	5	47	(20)	(3)
	Cash flow from operations	146	50	77	16	33
	Capex	(1)	(0)	(0)	(0)	(0)
	Cash flow from investing activities	63	11	71	29	33
	Dividends paid	(29)	(28)	(30)	(18)	(21)
	Cash flow from financing activities	(152)	(41)	(30)	(18)	(21)
	Cash at beginning of period	300	358	379	497	523
	Net change in cash	57	20	118	26	45
	Ending balance cash	358	379	497	523	568
	Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	358	379	497	523	568
	Tangible fixed assets	5	20	15	12	10
	Total investments	311	362	318	325	331
	Total assets	1,653	1,868	1,452	1,688	1,768
	Total liabilities	884	1,033	594	780	808
	Total equity	769	835	857	908	960
	Total liabilities & equity	1,653	1,868	1,452	1,688	1,768
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	26.7	(1.3)	(51.0)	44.1	4.5
	Recurrent EPS growth (%)	9.8	6.4	(47.7)	30.6	7.2
	Gross margin (%)	0.2	0.3	0.4	0.4	0.4
	Operating EBITDA margin (%)	0.1	0.2	0.4	0.3	0.3
	Net profit margin (%)	0.5	0.5	0.5	0.5	0.5
	Dividend payout ratio (%)	31.1	28.5	57.2	26.0	28.5
	Capex/sales (%)	0.0	0.0	0.0	0.0	0.0
	Interest cover (x)	9.06	39.92			

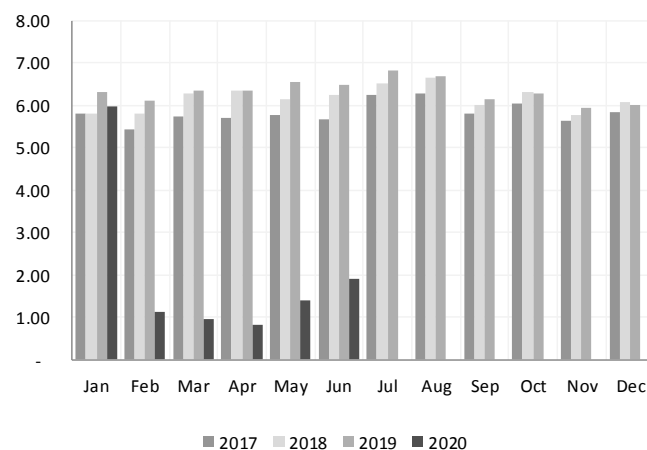
Source: Company data, RHB

Figure 1: Monthly flights handled - Shanghai Pudong ('000)



Source: CEIC, Bloomberg

Figure 2: Monthly passenger traffic - Shanghai Pudong (m)



Source: CEIC, Bloomberg

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Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-07-05	Buy	1.25	1.02
2020-03-11	Buy	1.30	0.97
2020-01-21	Buy	1.55	1.27
2019-09-02	Buy	1.50	1.14
2019-08-07	Buy	1.60	1.23

Source: RHB, Bloomberg

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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

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

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RHB Securities Singapore Pte Ltd.

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