

Singapore Company Update

China Aviation Oil

Bloomberg: CAO SP | Reuters: CNAO.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 Jan 2021

BUY

Last Traded Price (22 Jan 2021): S\$1.15 (STI : 2,991.53)

Price Target 12-mth: S\$1.38 (20% upside) (Prev S\$1.20)

Analyst

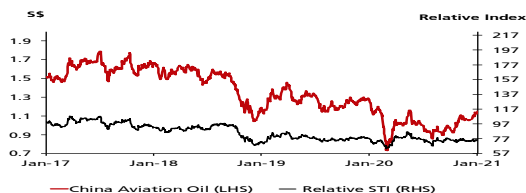
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What's New

- 2H20 earnings poised for a strong rebound, led by key associate SPIA as traffic at Shanghai Pudong International Airport has bounced on firm domestic air travel
- Expect steady improvement from FY21F onwards as international travel starts to recover in 2H21
- Net cash of c.US\$400m for accretive acquisitions
- Maintain BUY with S\$1.38 target price as we roll over valuation multiple to 11x FY21F PE

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2019A	2020F	2021F	2022F
Revenue	20,343	9,991	12,822	16,062
EBITDA	110	61.4	87.7	100
Pre-tax Profit	106	59.0	85.5	98.2
Net Profit	99.8	54.9	79.6	91.4
Net Pft Gth (Pre-ex) (%)	6.4	(45.0)	45.0	14.8
EPS (S cts)	15.4	8.47	12.3	14.1
EPS Gth Pre Ex (%)	6	(45)	45	15
Diluted EPS (S cts)	15.4	8.47	12.3	14.1
Net DPS (S cts)	4.63	2.54	3.69	4.23
BV Per Share (S cts)	129	135	143	153
PE (X)	7.5	13.6	9.4	8.1
EV/EBITDA (X)	3.4	4.7	2.9	2.1
Net Div Yield (%)	4.0	2.2	3.2	3.7
P/Book Value (X)	0.9	0.9	0.8	0.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	12.4	6.4	8.8	9.5

Earnings Rev (%)		1	(2)	N/A
Consensus EPS (S cts)		8.10	11.3	7.97
Other Broker Recs:		B: 2	S: 0	H: 1

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Still undervalued at <3x ex-cash PE

Investment Thesis:

Recommend BUY with raised TP of S\$1.38 as we roll over our valuation multiple of 11x to FY21F earnings. We continue to see strong value for CAO at less than 3x FY21F ex-cash PE, and its share price could re-rate even further if the company can make a significant earnings-accretive acquisition.

Beneficiary of the strong recovery in China's domestic air traffic at Shanghai Pudong International Airport (SPIA). Departing frequencies at SPIA has picked up substantially since May 2020, reaching c.70% of pre-COVID-19 levels in Jan 2021, and should stay firm as long as the pandemic remains under control in China. Hence, CAO's earnings should improve materially from 2H20 as key 33%-owned associate SPIA (which is the sole supplier of jet fuel for the airport) typically accounts for more than half of its earnings.

International air travel recovery in sight as vaccinations are rolled out. CAO's supply volumes should start to pick up more meaningfully from 2H21, assuming the vaccinations being rolled out now in key aviation markets will allow international flights to resume in greater numbers. Meanwhile, its trading business should continue to do well in a contango market for oil.

Valuation:

TP of S\$1.38 based on 11x FY21 PE. With the worst for the aviation sector likely behind us, we value the company based on 11x (+1 SD of its mean) FY21 PE as earnings are set to recover firmly in the next 12 months. Our TP is lifted from S\$1.20 previously as we roll over to FY21F numbers.

Where we differ:

We have higher-than-consensus forecasts for FY21F and FY22F as we are more bullish on the earnings recovery trajectory for its key associate SPIA.

Key Risks to Our View:

A sustained weaker demand for international air travel would negatively impact CAO's revenue and earnings. A sharp drop in oil prices would lead to mark-to-market losses for its key associate SPIA, which would impact its contribution to CAO.

At A Glance

Issued Capital (m shrs)	860
Mkt. Cap (S\$m/US\$m)	989 / 745
Major Shareholders (%)	
China National Aviation Fuel Group Ltd	51.3
BP PLC	20.2
Free Float (%)	28.5
3m Avg. Daily Val (US\$m)	0.44
GIC Industry : Energy / Oil, Gas & Consumable Fuels	



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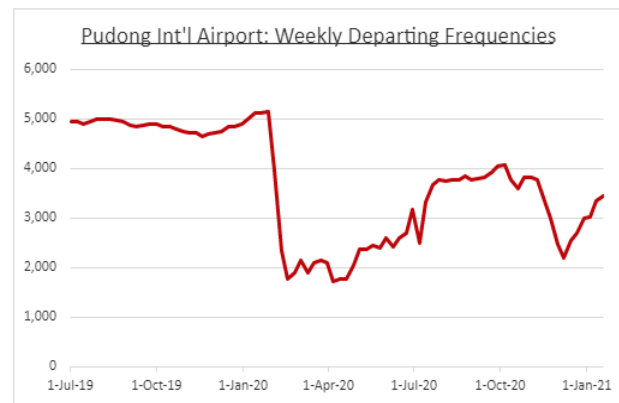
WHAT'S NEW

Air travel rebound in sight, driving volumes and earnings

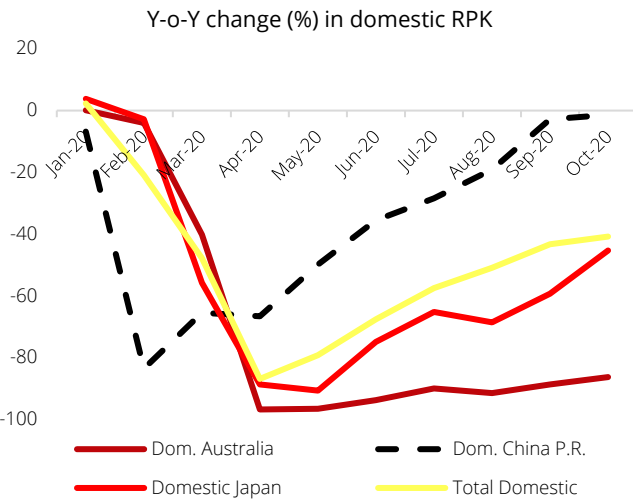
Domestic air travel recovery is well underway. Domestic revenue-passenger-kilometers (RPK) in China had largely returned to pre-COVID-19 levels in Oct 2020, which is no surprise given that the country has managed to swiftly control the spread of the virus. China has also kickstarted an ambitious inoculation plan of vaccinating 50 million people by early Feb 2021, which is the peak travel season for the Lunar New Year, before rolling out a free national immunisation programme for the general public.

We believe that domestic travel will remain firm going forward as there will be increased confidence in travelling after mass vaccinations and pent-up demand will first drive domestic travel as international borders are likely to remain closed. Even after the opening of international borders, domestic flights should remain resilient as consumers largely perceive domestic markets to be safer, and also want to minimise time spent in an enclosed area.

Stronger earnings contribution from SPIA, as departing frequencies recover. Weekly departing frequencies at Shanghai Pudong International Airport dipped to c. 2,000 in Dec 2020 due to a resurgence of cases but it has since rebounded to c. 3,500 in Jan 2021. Going forward, volumes should stay firm as long as the pandemic remains under control in China. Hence, CAO's earnings should improve materially from 2H20 as SPIA typically accounts for more than half its earnings.



Source: CAPA, DBS Bank

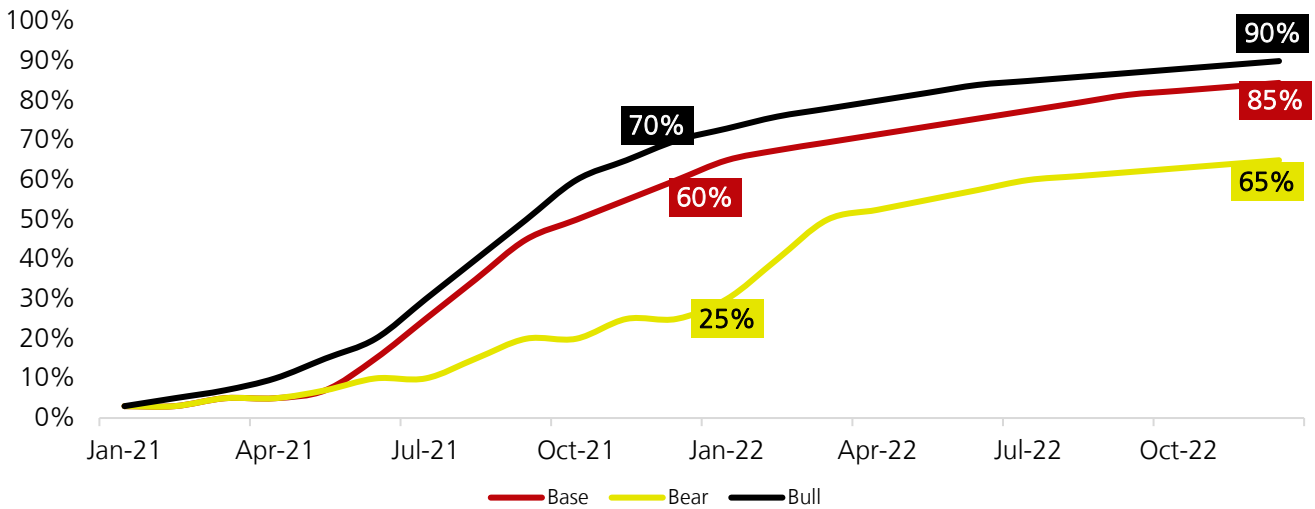


Source: IATA, DBS Bank

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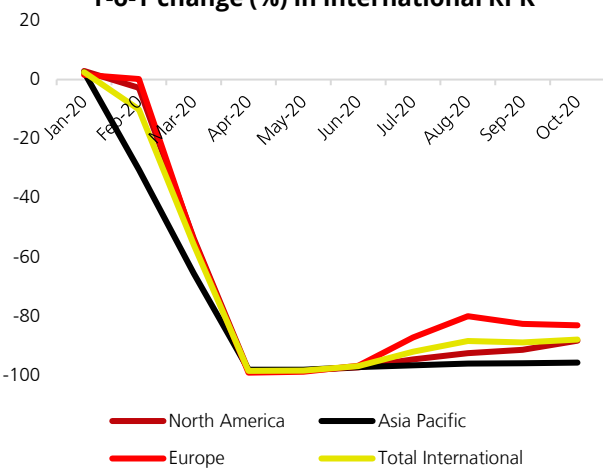
Forecasts of international travel activity under the various scenarios

2019 = base level



Source: DBS Bank estimates

Y-o-Y change (%) in international RPK



International air travel recovery to lag domestic recovery. With travel restrictions and border closures in place, international revenue-passenger-kilometers (RPK) remains in the negative y-o-y growth territory. The turnaround trajectory for international travel will likely be bumpy, with developed countries that have secured significant vaccine doses emerging out of the crisis first. The turnaround in international travel activity in countries with a relatively lower vaccine coverage would likely trail other countries, as inbound travellers would opt to avoid these countries, while outbound travellers who have not been inoculated could be denied entry into other countries.

However, we expect international air travel recovery to gain strong momentum from 2H21, as key aviation markets serviced by CAO have fairly high vaccine coverage. According to estimates by the [Bloomberg COVID vaccine tracker](#), US, Australia, South Korea, Japan, Hong Kong, Macau, India and Indonesia have secured significant quantities of doses to inoculate most of their populations. We forecast international travel activity to reach 60% of 2019 levels by end-2021 (See our [2021 Regional Airlines Sector Outlook: The vaccines are here, but the skies are not clear yet](#)).

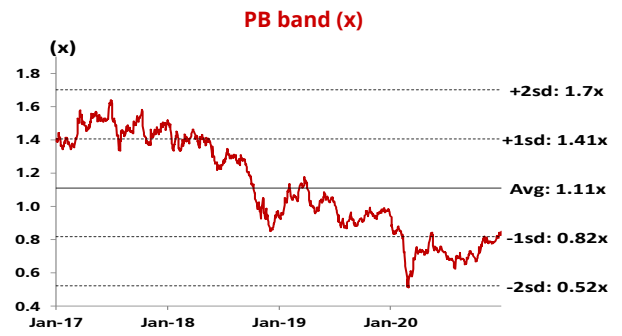
CAO's supply volumes should start to pick up more **meaningfully from 2H21**, assuming the vaccinations being rolled out now in key aviation markets will allow international flights to resume in greater numbers. Meanwhile, its trading business should continue to do well in a contango market for oil.

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Historical PE and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

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Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Middle Distillates	18.2	22.3	16.7	18.4	21.1
Other Oil Product	14.3	14.7	11.0	12.1	13.9
Implied Average Middle	85.6	82.5	48.3	56.4	61.4
Gross Profit per Tonne	1.54	1.58	1.74	1.65	1.65
Contribution from	72.1	65.5	25.0	50.5	57.1

Segmental Breakdown

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenues (US\$m)					
Middle distillates	12,362	13,594	6,397	8,209	10,283
Other oil products	8,250	6,749	3,595	4,613	5,779
Total	20,612	20,343	9,991	12,822	16,062

Income Statement (US\$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenue	20,612	20,343	9,991	12,822	16,062
Cost of Goods Sold	(20,562)	(20,285)	(9,943)	(12,772)	(16,004)
Gross Profit	50.0	58.5	48.2	50.4	58.0
Other Opng (Exp)/Inc	(16.9)	(14.8)	(12.7)	(14.2)	(15.7)
Operating Profit	33.1	43.7	35.5	36.2	42.3
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	72.1	65.5	25.0	50.5	57.1
Net Interest (Exp)/Inc	(4.6)	(2.8)	(1.5)	(1.2)	(1.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	101	106	59.0	85.5	98.2
Tax	(6.7)	(6.6)	(4.1)	(6.0)	(6.9)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	93.9	99.8	54.9	79.6	91.4
Net Profit before Except.	93.9	99.8	54.9	79.6	91.4
EBITDA	106	110	61.4	87.7	100
Growth					
Revenue Gth (%)	26.7	(1.3)	(50.9)	28.3	25.3
EBITDA Gth (%)	11.1	3.8	(44.2)	42.7	14.5
Opg Profit Gth (%)	43.4	32.0	(18.7)	2.1	16.8
Net Profit Gth (Pre-ex) (%)	10.5	6.4	(45.0)	45.0	14.8
Margins & Ratio					
Gross Margins (%)	0.2	0.3	0.5	0.4	0.4
Opg Profit Margin (%)	0.2	0.2	0.4	0.3	0.3
Net Profit Margin (%)	0.5	0.5	0.5	0.6	0.6
ROAE (%)	12.6	12.4	6.4	8.8	9.5
ROA (%)	5.3	5.7	3.3	5.1	5.2
ROCE (%)	3.8	5.0	3.8	3.7	4.0
Div Payout Ratio (%)	30.2	30.0	30.0	30.0	30.0
Net Interest Cover (x)	7.1	15.9	23.7	30.2	35.2

Source: Company, DBS Bank

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Balance Sheet (US\$m)

FY Dec	2018A	2019A	2020F	2021F	2022E
Net Fixed Assets	5.25	4.91	4.81	4.72	4.62
Invt in Associates & JVs	311	362	369	377	386
Other LT Assets	6.17	25.4	25.1	24.9	24.6
Cash & ST Invt	358	379	459	496	538
Inventory	111	58.7	28.8	36.9	46.3
Debtors	862	894	439	563	706
Other Current Assets	0.0	145	145	145	145
Total Assets	1,653	1,868	1,470	1,648	1,850
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	875	860	421	541	678
Other Current Liab	0.83	158	160	162	163
LT Debt	0.0	3.92	3.92	3.92	3.92
Other LT Liabilities	8.05	11.7	11.7	11.7	11.7
Shareholder's Equity	769	835	873	929	993
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	1,653	1,868	1,470	1,648	1,850
Non-Cash Wkg. Capital	96.6	79.5	31.0	41.8	55.6
Net Cash/(Debt)	358	375	456	492	534
Debtors Turn (avg days)	17.1	15.8	24.3	14.3	14.4
Creditors Turn (avg days)	17.2	15.6	23.5	13.8	13.9
Inventory Turn (avg days)	2.8	1.5	1.6	0.9	0.9
Asset Turnover (x)	11.6	11.6	6.0	8.2	9.2
Current Ratio (x)	1.5	1.5	1.8	1.8	1.7
Quick Ratio (x)	1.4	1.3	1.5	1.5	1.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	14.7	14.7	14.7	14.7
Z-Score (X)	13.9	12.2	8.6	10.0	10.0

Source: Company, DBS Bank

Cash Flow Statement (US\$m)

FY Dec	2018A	2019A	2020F	2021F	2022E
Pre-Tax Profit	101	106	59.0	85.5	98.2
Dep. & Amort.	0.94	11.6	0.94	0.94	0.94
Tax Paid	(0.7)	(0.8)	(2.1)	(4.1)	(6.0)
Assoc. & JV Inc/(loss)	(72.1)	(65.5)	(25.0)	(50.5)	(57.1)
Chg in Wkg.Cap.	118	16.0	46.4	(12.7)	(14.7)
Other Operating CF	(0.4)	(11.4)	0.0	0.0	0.0
Net Operating CF	146	56.3	79.2	19.2	21.4
Capital Exp.(net)	(1.1)	(0.6)	(0.6)	(0.6)	(0.6)
Other Invt.(net)	(7.6)	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	67.4	3.62	18.5	41.9	48.2
Other Investing CF	4.58	0.0	0.0	0.0	0.0
Net Investing CF	63.2	3.05	17.9	41.3	47.6
Div Paid	(29.2)	(28.5)	(16.5)	(23.9)	(27.4)
Chg in Gross Debt	(120)	(10.7)	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(3.2)	0.0	0.0	0.0	0.0
Net Financing CF	(152)	(39.2)	(16.5)	(23.9)	(27.4)
Currency Adjustments	0.24	0.90	0.0	0.0	0.0
Chg in Cash	57.7	21.1	80.7	36.6	41.6
Opg CFPS (S cts)	4.37	6.23	5.07	4.92	5.57
Free CFPS (S cts)	22.5	8.61	12.2	2.87	3.21

Source: Company, DBS Bank

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Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	26 Feb 20	1.16	1.65	BUY
2:	24 Aug 20	0.86	1.20	BUY

Note : Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Paul YONG, CFA

Jason SUM

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DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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