

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

3 Mar 2022

HOLD (Downgrade from BUY)

Last Traded Price (2 Mar 2022): S\$0.91 (STI : 3,244.40)
Price Target 12-mth: S\$0.85 (7% downside) (Prev S\$1.20)

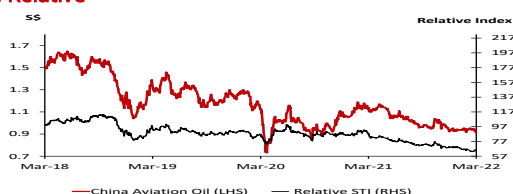
Analyst

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What's New

- Downgrade to HOLD with lower TP of S\$0.85 to reflect negative earnings revisions and less optimistic outlook
- 2H21 net profit estimate below expectations
- Final DPS of 1.90Scts also missed estimates
- Net cash position improved, but we do not see a clear path to enhancing shareholder returns

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2020A	2021A	2022F	2023F
Revenue	10,517	17,637	25,016	29,943
EBITDA	62.4	47.1	52.6	77.6
Pre-tax Profit	60.2	44.4	50.0	75.0
Net Profit	56.2	40.4	46.6	70.0
Net Pft (Pre Ex.)	56.2	40.4	46.6	70.0
Net Pft Gth (Pre-ex) (%)	(43.7)	(28.2)	15.5	50.1
EPS (S cts)	8.87	6.37	7.36	11.0
EPS Pre Ex. (S cts)	8.87	6.37	7.36	11.0
EPS Gth Pre Ex (%)	(44)	(28)	15	50
Diluted EPS (S cts)	8.87	6.37	7.36	11.0
Net DPS (S cts)	2.66	1.91	2.21	3.31
BV Per Share (S cts)	138	142	147	155
PE (X)	10.3	14.3	12.4	8.2
PE Pre Ex. (X)	10.3	14.3	12.4	8.2
P/Cash Flow (X)	nm	5.0	nm	nm
EV/EBITDA (X)	4.9	3.9	3.5	2.4
Net Div Yield (%)	2.9	2.1	2.4	3.6
P/Book Value (X)	0.7	0.6	0.6	0.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	6.6	4.5	5.1	7.3
Earnings Rev (%):			(41)	-
Consensus EPS (S cts):			10.9	12.1
Other Broker Recs:		B: 1	S: 0	H: 1

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

Turning neutral on the stock

Investment Thesis:

Protracted backwardation in crude oil/oil product market will erode profitability. Improving crude oil demand and concerns of supply disruption amid sanctions on Russia, the world's second largest exporter of crude oil, drove backwardation in the crude oil market to the steepest level since 2004. We believe that the crude oil/oil product market will remain tight for some time, making it challenging for the group's trading operations.

Delayed reopening of China's international market will be a drag on earnings. CAO's key associate, Shanghai Pudong International Airport Aviation Fuel Supply Company (SPIAAFSC), which typically accounts for more than half of its earnings, is highly dependent on international traffic. Hence, the sluggish relaxation of international border controls will likely impede SPIAAFSC's earnings recovery.

Substantial net cash position, but no clear path to enhancing shareholder returns. CAO had net cash of US\$401m as of December 2021, representing S\$0.63 per share. Though CAO's net cash position is substantial, we are doubtful on the group's ability to put that capital to work in a manner that would drive shareholder returns.

Valuation:

Our TP of S\$0.85 is based on 11.0x FY22F earnings, which is at +1.0 standard deviation above its five-year mean.

Where we differ:

Our forecasts for FY22/23F are lower than the consensus, as we are less bullish on the recovery trajectory for CAO and its key associate SPIAAFSC.

Key Risks to Our View:

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

At A Glance

Issued Capital (m shrs)	860
Mkt. Cap (S\$m/US\$m)	783 / 576
Major Shareholders (%)	
China National Aviation Fuel Group Ltd	51.3
BP Investments	20.2
Free Float (%)	28.5
3m Avg. Daily Val (US\$m)	0.11



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WHAT'S NEW

2H21 missed expectations; downgrade to HOLD

2H21 net profit of US\$16.1m (-50.8% h-o-h, -33.9% y-o-y) was below our expectations, bringing full-year net profit to US\$40.4m, which was 31.2% below our FY21 estimate. Underperformance in 2H21 was primarily due to lower-than-expected supply and trading volumes (-7.7% h-o-h, +13.3% y-o-y) and decline in refuelling volumes at its key associate, Shanghai Pudong International Airport Aviation Fuel Supply Company (SPIAAFSC), and poor performance at another associate, Oilhub Korea Yeosu Co. Ltd. Gross profit realised per tonne in 2H21 was essentially flat h-o-h, but gross profit per tonne for the full year dived to US\$1.3 per tonne (-32% y-o-y) as trading conditions deteriorated.

Final dividend of 1.90Scts missed our estimate. CAO declared a final dividend of 1.90Scts per share, down from 2.58Scts in FY20, driven by a decline in its net earnings as the company maintained its 30% payout ratio.

Net cash position strengthened to US\$401m as of Dec 21, up from US\$269m in Dec 20, due to favourable working capital changes, though offset by considerably lower dividends from its associates.

No direct impact from sanctions on Russia. Based on the group's risk assessment, sanctions on Russia are unlikely to affect its business, as they do not have trade exposure with Russian-based companies.

Cut FY22F net profit estimate by 41.0%; introduce FY23F projection. We are slashing our FY22F net profit estimate by 41% to account for the following factors:

1. **Protracted backwardation in crude oil product markets will weigh on trading profits:** We are pencilling in a 10% decline in gross profit per tonne in FY22F as we now expect crude oil prices to stay backwardated for some time, given how tight the market is at the current juncture, especially with geopolitical tensions over in Europe.
2. **Omicron will be a drag on domestic and international flight activity in China:** The highly transmissible variant has penetrated China's formidable defences, and we

could see an increase in the frequency of domestic lockdowns as China maintains its COVID zero policy. Additionally, we now only expect China to ease international travel restrictions towards the end of 2022 at the earliest, given that multiple studies have shown the limited efficacy of Chinese vaccines against the problematic variant. This is negative for SPIAAFSC, as the airport is highly dependent on international flights.

Downgrade to HOLD with a lower TP of S\$0.85. We are lowering our TP to S\$0.85 (11.0x FY22F P/E, +1.0 standard deviation above five-year average) and cutting our recommendation to HOLD to factor in our negative earnings revision and less optimistic outlook on the group. Though CAO has a robust net cash position of US\$401m (S\$0.63 per share), we are not convinced that the group will deploy its capital efficiently to maximise returns for shareholders. Furthermore, CAO's FY22F dividend yield of 2.4% is also less attractive compared to other quality dividend plays in the market.

We will stay on the sidelines until we see 1) greater clarity on China's reopening trajectory, 2) a shift in the group's mentality towards returning capital to shareholders (dividend payout ratio has been maintained at 30% for a long time) to drive a higher return on equity, or 3) earnings-accretive acquisitions by the group to drive inorganic earnings growth.

Company Background

China Aviation Oil (Singapore) Corporation Ltd. is the largest physical jet fuel trader in the Asia Pacific region and the key supplier of imported jet fuel to China's civil aviation industry. It also has investments in oil-related assets, the most significant of which is a 33% stake in the sole jet refueller at Shanghai Pudong International Airport known as Shanghai Pudong International Airport Aviation Fuel Supply Company.

China Aviation Oil

Peer comparison table

Company	Market cap (US\$m)	P/E		EV-to-EBITDA		P/B		ROE (%)		Div Yield (%)	
		CY22F	CY23F	CY22F	CY23F	CY22F	CY23F	CY22F	CY23F	CY22F	CY23F
World Fuel Services Corp	1,750	15.1x	11.8x	nm	nm	nm	nm	702.0%	nm	1.7%	nm
Z Energy Limited	1,276	18.3x	18.4x	7.3x	7.0x	1.9x	1.9x	9.4%	11.0%	6.8%	7.6%
China Aviation Oil	582	8.4x	7.5x	7.7x	nm	0.6x	0.6x	7.5%	7.7%	2.8%	3.0%
Sector average		13.9x	12.6x	7.5x	7.0x	1.2x	1.2x	239.6%	9.3%	3.8%	5.3%

Source: Bloomberg Finance L.P., DBS Bank

Historical PE and PB band



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



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

China Aviation Oil

Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Middle Distillates Volumes (m tonnes)	22.3	14.3	13.9	14.8	18.5
Other Oil Product Volumes (m tonnes)	14.7	9.29	9.40	9.68	11.1
Gross Profit per Tonne (US\$)	1.58	1.95	1.32	1.19	0.80
Contribution from Associates (US\$ m)	65.5	25.0	23.6	30.5	43.8

Segmental Breakdown

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (US\$m)					
Middle distillates	13,594	5,630	8,116	11,749	14,686
Other oil products	6,749	4,887	9,521	13,267	15,257
Total	20,343	10,517	17,637	25,016	29,943

Income Statement (US\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	20,343	10,517	17,637	25,016	29,943
Cost of Goods Sold	(20,285)	(10,471)	(17,606)	(24,987)	(29,902)
Gross Profit	58.5	45.9	30.7	29.1	41.5
Other Opng (Exp)/Inc	(14.8)	(9.3)	(8.1)	(7.9)	(8.6)
Operating Profit	43.7	36.6	22.6	21.1	32.9
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	65.5	24.8	23.6	30.5	43.8
Net Interest (Exp)/Inc	(2.8)	(1.2)	(1.7)	(1.7)	(1.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	106	60.2	44.4	50.0	75.0
Tax	(6.6)	(4.1)	(4.1)	(3.4)	(5.0)
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	99.8	56.2	40.4	46.6	70.0
Net Profit before Except.	99.8	56.2	40.4	46.6	70.0
EBITDA	110	62.4	47.1	52.6	77.6
Growth					
Revenue Gth (%)	(1.3)	(48.3)	67.7	41.8	19.7
EBITDA Gth (%)	3.9	(43.4)	(24.5)	11.7	47.6
Opg Profit Gth (%)	32.0	(16.1)	(38.3)	(6.4)	55.8
Net Profit Gth (Pre-ex) (%)	6.4	(43.7)	(28.2)	15.5	50.1
Margins & Ratio					
Gross Margins (%)	0.3	0.4	0.2	0.1	0.1
Opg Profit Margin (%)	0.2	0.3	0.1	0.1	0.1
Net Profit Margin (%)	0.5	0.5	0.2	0.2	0.2
ROAE (%)	12.4	6.6	4.5	5.1	7.3
ROA (%)	5.7	3.0	2.4	2.7	3.3
ROCE (%)	5.0	3.9	2.3	2.1	3.2
Div Payout Ratio (%)	28.9	29.9	30.0	30.0	30.0
Net Interest Cover (x)	15.9	31.6	13.4	12.5	19.5

Source: Company, DBS Bank

China Aviation Oil

Cash Flow Statement (US\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	106	60.2	44.4	50.0	75.0
Dep. & Amort.	11.6	12.0	8.78	0.95	0.95
Tax Paid	(0.8)	(2.3)	(0.3)	(0.8)	(3.4)
Assoc. & JV Inc/(loss)	(65.5)	(24.8)	(23.6)	(30.5)	(43.8)
Chg in Wkg.Cap.	16.0	(213)	86.8	(29.1)	(49.7)
Other Operating CF	(11.4)	5.86	(1.7)	0.0	0.0
Net Operating CF	56.3	(162)	114	(9.5)	(20.9)
Capital Exp.(net)	(0.6)	(0.3)	(0.3)	(0.5)	(1.0)
Other Invs.(net)	0.0	0.0	0.0	0.0	0.0
Invs in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	3.62	92.4	42.9	24.2	36.4
Other Investing CF	0.0	0.0	0.0	0.0	0.0
Net Investing CF	3.05	92.1	42.6	23.7	35.4
Div Paid	(28.5)	(28.8)	(16.8)	(14.0)	(21.0)
Chg in Gross Debt	(10.7)	(11.1)	(8.5)	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	(39.2)	(39.9)	(25.2)	(14.0)	(21.0)
Currency Adjustments	0.90	0.11	(0.1)	0.0	0.0
Chg in Cash	21.1	(110)	132	0.24	(6.5)
Opg CFPS (S cts)	6.37	8.07	4.36	3.09	4.55
Free CFPS (S cts)	8.80	(25.6)	18.0	(1.6)	(3.5)

Source: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	02 Aug 21	1.00	1.20	BUY

Source: DBS Bank

Analyst: Jason SUM, CFA

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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