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China Aviation Seeks Protection After Bad Bets on Oil (Update5)

Dec. 1 (Bloomberg) -- China Aviation Oil (Singapore) Corp., which supplies almost all of China's jet fuel imports, will ask Singapore's High Court for protection from creditors after losing about $550 million from wrong-way bets on oil prices.

The company suspended Chief Executive Chen Jiulin and is seeking a rescue by its Chinese parent and Singapore state investment agency Temasek Holdings Pte, it said in a statement late yesterday. Parent China Aviation Oil Holding Co. and Temasek may invest $50 million each.

The trading unit ran up losses as New York oil futures soared to a record $55.67 a barrel on Oct. 25, partly because of surging demand from China. Chen, who led an initial share sale in Singapore in 2001 and planned to expand into refining, stumbled as the company began betting its own money on oil prices last year.

``It's just another example of a company that starts trading without the necessary controls and expertise,'' Michael Coleman, managing director of Singapore-based hedge fund Aisling Analytics Pte and a China Aviation shareholder, said in an telephone interview in Tokyo.

The company's trading loss is close to its market value of $570 million after a 49 percent slump in the stock since its all- time high on March 23.

Margin Calls

``In October 2004, international oil prices rose steeply, leading to the company having to face significant margin calls,'' it said, referring to demands for funds to guarantee derivatives contracts. ``The company was unable to meet some of the margin calls.''

The parent company sold a 15 percent stake in China Aviation for S$196 million ($120 million), according to a statement from the sale manager Deutsche Bank AG on Oct. 21, the day before New York oil futures had a record closing price of $55.17 a barrel.

Deutsche Bank's Hong Kong-based spokesman Mike West declined to comment.

Seventy-five percent of the stock was bought by institutional investors from Asia and the remainder from Europe and elsewhere, China Aviation said in a statement to the stock exchange. Orders for the stock exceeded the amount on offer.

The parent is wholly owned by China's State-owned Assets Supervision and Administration Commission, a unit of the State Council, or cabinet. Ji Xiaonan, a spokesman for the commission, declined to comment on ``individual corporate behavior.''

Recovery Team

Gu Yanfei, an executive in charge of the investment department of the parent company, was sent to the listed company to head a four-member team to reorganize the business, said Gerald Woon, a public relations official representing China Aviation Oil Holding.

``The task force has been managing the day-to-day operation of the Singapore company, working on restructuring and rehabilitation,'' Woon said. ``There is no timetable set for the remedial work.''

China Aviation's financial crisis ``raises serious concerns about corporate governance in Chinese companies,'' said David Gerald, chief executive of the Securities Investors Association (Singapore). ``It's mind-boggling what has happened.''

The shares closed at 96.5 Singapore cents on Nov. 26, before trading was halted two days ago on the Singapore Exchange pending an announcement. The suspension will continue until further notice, the company said.

Temasek controls less than 2 percent of China Aviation's stock, said Serene Lee, a Temasek spokeswoman.

Stakeholders

``We're open to working with China Aviation Oil Holding and other interested stakeholders to develop a commercially acceptable proposal,'' Lee said, declining to give more details.

DBS Group Holdings Ltd.'s ``exposure is minimal,'' said Eileen Lau, a spokeswoman for the bank, which owns no China Aviation shares.

Officials at Bank of Communications and Nantexis Banques Populaires, among the company's bankers according to its annual report, declined to comment. Officials at Industrial & Commercial Bank of China weren't immediately available to comment.

``Our policy is not to comment on specific client exposure, but our exposure to China Aviation is quite small,'' said Laura Schalk, a spokeswoman for Societe Generale SA in Hong Kong. She declined to elaborate.

Rise, Fall

China Aviation's shares had soared as much as sevenfold after the initial share sale in 2001 as the company announced plans to refine, store and trade oil in Singapore, the Middle East and Europe. Singapore is Asia's biggest oil trading center, where about $100 billion worth of fuels are traded a year. The stock plummeted as those plans unraveled.

``Their core business is in jet fuel trading, and they shouldn't have gone into other businesses,'' said Ong Eng Tong, a Singapore-based independent fuel consultant. ``Obviously, they went out of control.''

A loan of $100 million from its Chinese parent company failed to keep it from being forced to liquidate trades. Accumulated losses from trading positions closed between Oct. 26 and yesterday totaled about $390 million, while closing the remaining trades is expected to cost another $160 million, the company said.

China Aviation in 2003 began speculative oil derivatives trading, in which the company bet its own money rather than simply executing trades for clients, the statement said.

Few Details

The company didn't say what kind of derivatives it traded, who it traded with, or where the trades were executed. Further discussion of the trading losses prior to completion of an investigation would be inappropriate, the company said in the statement.

Derivatives are contracts whose value is tied to another security, such as a stock, bond or commodity. Energy derivatives include futures on oil and oil-based fuels and related options contracts.

In Singapore, so-called over-the-counter trading of oil for future settlement, known as swaps, isn't regulated by any exchange. In an energy swap, one party agrees to pay the other any difference between the current and future price of oil for delivery in the future. Singapore needs a clearing system to register, match and guarantee swaps trades, Aisling's Coleman said.

``It's another push for a clearing system in Singapore's over-the-counter market,'' Coleman said.

China Aviation said Nov. 16 that it would end most trading of oil and fuel derivatives because of losses. The company's stock fell 23 percent last week as a plan to buy a 20.6 percent stake in refiner Singapore Petroleum Co. was blocked by its parent company, which owns about 60 percent of the Singapore-traded shares.

Bad Bets

The loss shows the risks that energy and commodity companies face in speculative commodities trading. Sumitomo Corp. lost $2.6 billion in 1996 in the copper market, while Metallgesellschaft AG lost more than $1.5 billion in oil trades in 1993.

Chief Executive Chen, who was 40 years old when the company sold shares for the first time in Singapore in late 2001, has been suspended while the company conducts an investigation, to be led by board member Gu Yanfei. The company said it was ordered by the Singapore exchange to have accounting firm PricewaterhouseCoopers conduct an investigation.

The company will propose a plan to creditors to pay debts and will ask the High Court of Singapore to fix a date to meet with creditors, the statement said.

On Nov. 24, the company said a plan to pay S$227 million ($139 million) for a 20.6 percent stake in Singapore Petroleum Corp., which owns half of Singapore Refining Co., the island's third-biggest oil refinery, was blocked by its parent.

Emirates Deal Over

China Aviation pulled out of a joint venture with a unit of Emirates National Oil Co. to build a $135 million oil terminal in Singapore, said an official from the Emirates National unit yesterday.

China Aviation announced the planned joint venture in March and said it may buy as much as 20 percent of Horizon Terminals Ltd., Emirates National's fuel-storage unit, to help secure supplies from the Middle East.

China Aviation withdrew from the project in early November, and Horizon is talking to other investors, Yusr Sultan, Horizon's chief executive officer said in a telephone interview.

``The project is going ahead as planned,'' he said.

The proposed terminal in Jurong Island in western Singapore would be for the storage of crude oil, fuels and edible oil.

U.K.-based Fortune Oil Plc said it's in talks with China Aviation and its parent company to establish whether China Aviation's purchase of Fortune Oil's 24.5 percent stake in South China Bluesky Aviation Oil Co. will be affected.

To contact the reporter on this story:
Nesa Subrahmaniyan in Singapore at nesas@bloomberg.net and
Hector Forster in Tokyo at hforster@bloomberg.net.

To contact the editor responsible for this story:
Reinie Booysen at rbooysen@bloomberg.net.

Last Updated: December 1, 2004 00:11 EST

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