3 Reasons to Like This Natural Gas Play Right Now

Description

By Neha Chamaria

I've thoroughly enjoyed watching **Westport Innovations** (TSX:WPT, NASDAQ:WPRT) stock fall off the cliff in recent months — it has lost a massive 28% since July, as of this writing. And no, I'm not short the stock.

Honestly, my hands were itching to get hold of some shares of the company that engineers natural-gas engines. With the recent drop in its stock price, I think the opportunity has arrived. Westport stock is currently flirting with its 52-week low, but here are three reasons why the stock may not stay there for long, and why you should consider it.

Understanding the fall
First things first: Why did Westport shares nosedive? It started when the company reported a five-fold jump in its quarterly losses for the three months ended June, topping it up with a lower guidance for the full year. Investors were upset, and Westport shares crumbled.

Just when it seemed that the worst was over, on Sept. 26, Westport announced an issue of 6 million additional shares at a price nearly 8% lower than the prevailing day's market price. Equity dilution and a lower price proved a double-whammy for existing investors.

So why should anyone be optimistic about Westport now?

The red could turn black soon
Westport's bleeding bottom line is the biggest detractor for prospective investors. The company is still in the growth stage, and has yet to turn in a profit. Westport lost nearly $66 million during the first half of the year. That compares to a loss of $99 million for the full year 2012.

Thankfully, a turnaround may be on its way, because some key products that Westport has been developing for years are near completion, and ready for launch. Westport's is a highly capital- intensive business with long gestation periods, so products can take years to build.

This April, Westport launched the ISX 12G engines, built under its 50-50 joint venture with engine leader **Cummins** (NYSE: CMI). The venture, better known as Cummins-Westport, or simply CWI, is among the major contributors to Westport's revenue — revenue from CWI has more than doubled since 2008. Westport counts ISX 12G as one of its strongest products ever, and some of the top trucking companies have already put their weight behind the engines.

For 2014, Westport has two key products lined up for launch. One is Volvo's 13-liter engine powered by Westport's high-pressure direct injection, or HDPI technology, built for the North American market. The second one is Westport's first-ever HDPI product for China — a 12-liter engine built in partnership with Weichai.

These engines could change Westport's fortunes, especially since they cater to the critical heavy-duty truck segment, and are aimed at two of the largest engine markets in the world. With their launch just some months away, investors can expect big news coming their way.

Beyond borders
While Westport's joint ventures with Cummins and Weichai are critical for its growth, its list of partners is much bigger — **Ford**, **Caterpillar**, **General Motors**, and **PACCAR** are just some of Westport's loyal customers. The solid customer base, together with Westport's global footprint, should take the company far. Aside from China, Westport's technology has already reached Europe, Asia, Latin America, and Russia.

Nevertheless, partnerships and global presence will not help Westport moving forward until the adoption of natural gas as an alternative fuel picks up. So what really are the prospects for the company in the future? Judging by recent industry developments and projections, it certainly looks good.

The real story
Natural gas as a vehicle fuel is gaining traction as evidenced by the increasing number of automotive companies that are joining hands with Westport. Demand from China is particularly strong — revenue from the Westport-Weichai venture hit $272 million last year, up from just $9.9 million in 2008.

What should encourage drivers to switch to natural gas? According to major natural-gas producer **Encana** (TSX: ECA), natural gas is 30% cheaper and much safer than gasoline, and emits 99% less sulfur dioxide than diesel, among other benefits. Encana projects gas prices to remain range-bound between $4 and $6 per MMBtu through 2020, which should make gas a viable fuel alternative. Moreover, with companies like **Shell** and **Clean Energy Fuels** pumping huge money into natural gas stations across the U.S., refueling shouldn't remain a problem for long.

Here's a chart from Encana's latest presentation projecting sector-wise demand for North American natural gas through 2020.

Encana chart

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Source: Encana corporate presentation, October 2013

As you can see, demand for natural gas is expected to jump significantly. As the first mover in the natural gas engine technology, Westport is best poised to reap the benefits of this opportunity.

The Foolish bottom line
Investors should remember that for a growing company like Westport, top line growth is more important than profits. But with game-changing products coming online, Westport could also break even within the next financial year. The company's gross margin is healthy at around 35%. I believe Westport's stock is on the verge of a turnaround. Prudent investors should keep a close tab on it.

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Disclosure: Fool contributor Neha Chamaria does not own shares in any of the companies mentioned at this time.

David Gardner owns shares of Ford. Tom Gardner owns shares of Paccar. The Motley Fool owns shares of Cummins, Ford, Paccar, and Westport Innovations.

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1. Investing

TICKERS GLOBAL

1. NASDAQ:WPRT (Westport Fuel Systems Inc.)
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