Is This Canada's Hottest Emerging Markets Infrastructure Play?

Description

For some time, I have been a tremendous fan of **Brookfield Infrastructure Partners**, which provides broad exposure to a range of developed and emerging markets. Another interesting opportunity for investors seeking emerging markets exposure is renewable energy utility **Polaris Infrastructure** (TSX:PIF). After losing 33% since the start of 2018, it appears attractively valued and is poised to deliver outsized returns.

Now what?

Polaris owns and operates the San Jacinto geothermal power plant in Nicaragua, which has net installed capacity of 72 megawatts from 13 production wells. The utility does appear attractively priced, trading with a price-to-book ratio of less than one and price of less than eight times forecast earnings.

The utility reported some solid second-quarter 2018 results. Net power generation was 139,143-megawatt hours (MWh), which was almost 8% greater than a year earlier. The increased electricity output was generated by higher incremental steam production from new wells that were connected in May 2018 and improved infrastructure, which made the San Jacinto facility more efficient. This — along with a 3% tariff increase — gave Polaris's earnings a healthy bump.

Adjusted EBITDA for the quarter was US$15 million, which was a notable 11% higher year over year. Net income for the period came to US$3.9 million, which was a remarkable three times greater than the equivalent period in 2017. That impressive improvement can be attributed to higher earnings and lower share-based compensation. Polaris's earnings should continue to grow at a healthy clip.

You see, the company has budgeted US$30 million for its 2018 drilling program, where it anticipates the completion of three new production wells and one new injection well. Polaris is also focused on driving greater efficiencies from the San Jacinto plant by improving various aspects of the operations. This should lead to higher power output and lower costs, which will drive earnings growth.

Polaris is developing the Casita-San Cristobal project located in Northwest Nicaragua, which it expects will be approved during the third quarter 2018 and financed by a funding package totaling US$40-45 million provided by the World Bank. The utility is also looking for opportunities to reduce costs and monetize other non-core assets, including geothermal projects in California, Nevada, and British Columbia, as it pivots to focusing on its core Nicaraguan operations.

Polaris finished the second quarter with a solid balance sheet, holding US$34.5 million in cash and long-term debt of US$149 million, which is a manageable 2.8 times adjusted EBITDA.

Those solid results underscore Polaris's attractiveness as an investment especially once its regular and sustainable quarterly dividend of US$0.15 per share is considered. Polaris has hiked its annual dividend every year since 2016 and is on track to increase it again at the end of 2018 if it continues to generate strong results. That dividend gives the company a juicy yield of just over 5%.

Nonetheless, while Polaris is an appealing renewable energy investment, it does come with considerable risk. As a microcap stock, it lacks the resources of other larger electric utilities, leaving it vulnerable to unexpected or significant changes in its operating environment. There is also a considerable amount of geopolitical risk associated with Polaris.

You see, Nicaragua is far from being a stable jurisdiction in which to operate. Like many Latin American countries, corruption, an opaque bureaucracy, and a lack of security pose challenges to any business operating in the nation. There is also a long history in Latin America of governments expropriating assets from foreign companies, although this typically only applies to natural resources rather than infrastructure.

Recently, Nicaragua has experienced a marked uptick in violence since the government announced that it would reform the pension system and shave 5% off benefits. This sparked a wave of protests that have morphed into spasms of bloody violence triggering a government crackdown, which has seen hundreds of people killed and thousands more flee the Latin American nation.

So what?

Polaris shapes up as an attractive play on renewable electricity generation. While it is certainly a risky investment for the reasons discussed, its focus on growing earnings and its dividend, along with that juicy 5% yield, makes it an extremely appealing investment for risk-tolerant investors seeking to diversify their portfolios.

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mattdsmith