



## An Overbaked Perception of Risk Makes Now the Time to Buy This Renewable Energy Utility

### Description

Clean energy utility **Polaris Infrastructure** ([TSX:PIF](#)) [experienced](#) a tough 2018 with the market marking down its stock by 42% over the last year. Much of this was driven by the economic crisis which emerged in Nicaragua early in 2018, as the government moved to cut back on spending as fiscal revenues plunged. That resulted in protests and a government crackdown, which resulted in hundreds dead and many more injured. The result was that it substantially ratcheted up the level of geopolitical risk in a country that had been one of the most peaceful and fastest-growing in Central America.

### Weak economic outlook

The violence sparked a massive flight of capital among foreign investors and derailed the economy, causing it to contract by some analysts' estimates by around 6% during 2018 compared to 4.9% growth in 2017. For 2019, gross domestic product (GDP) is forecast to contract by 2%, and the economic outlook remains poor. This is being exacerbated by U.S. sanctions, including threats to impose an embargo on international lenders providing loans to the embattled Ortega administration. The economic and political crisis underway in Nicaragua could significantly impact Polaris's financial performance over the short term.

While this certainly increases the degree of risk associated with Polaris's operations, it is unlikely that there will be any significant impact on its [primary utility business](#) operating in Nicaragua, the 77-megawatt (MW) San Jacinto-Tizate geothermal plant. This facility is responsible for generating Polaris's earnings at this time.

Nonetheless, Polaris's recent acquisition of Union Energy Group reduces its dependence on its Nicaraguan operations. This has added the Canchayllo run-of-river five-MW hydro plant to Polaris's operations. That plant has been operational since 2015 and has an inflation-adjusted power-purchase agreement (PPA) with the Peruvian Ministry of Energy and Mines which expires in 2034. This asset alone will add up to \$1.5 million in revenue.

The deal also adds the 29 MW Generación Andina project, also located in Peru, to the utility's assets. That facility is currently under construction, requires an additional investment of US\$35 million, and is expected to be completed by the fourth quarter 2019. On commissioning, this operation will add up to US\$10 million to Polaris's revenue and an estimated US\$7 million to US\$9 million in annual EBITDA. There is also the 20 MW Karpa development stage project in Peru, which is currently being appraised.

Polaris expects to fund the construction of Andina and Karpa through a combination of cash flow and existing cash on hand. The company was also able to restructure Union Energy Group's debt as part of the conditions for completing the deal. That saw Union Energy Group's debt reduced by US\$11 million to US\$44 million, the interest rate reduced to 0%, and the loan term extended to 2038.

## Stable, rapidly growing economy

Peru is a far more stable and business-friendly jurisdiction than Nicaragua, and the deal goes a long way to reducing much of the geopolitical risk associated with investing in Polaris. The Andean nation's economy is also growing at a rapid clip.

GDP for 2019 is forecast to expand by around 4% and keep growing at a similar clip over following years. There is a direct correlation between GDP growth and rising demand for electricity. This bodes well for greater power consumption from Polaris's Peruvian assets and its ability to renegotiate contracted prices when the opportunity arises.

## Why buy Polaris?

Polaris is a risky investment. Current ructions in Nicaragua could impact its performance, and the deteriorating economic environment could lead to lower demand for electricity. It does appear, however, that the market is overbaking the level of risk and has failed to take into account the favourable purchase of Union Energy Group. This deal reduces much of the geopolitical risk associated with investing in the utility while diversifying its earnings and gives Polaris considerable exposure to Peru's rapidly growing economy.

### CATEGORY

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1. TSX:PIF (Polaris Renewable Energy)

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