



Value Investors: This Renewable Energy Stock Is Dirt Cheap

Description

Barring some sort of miracle collapse over the next couple weeks, 2019 will be remembered as a fantastic year for the Canadian renewable energy sector. It seems like every company in the space had a fantastic year.

It's easy to see why investors are excited about the industry. There are terrific growth opportunities to build new power generation facilities that are more environmentally sound.

These stocks tend to pay [succulent dividends](#). Investors get to play a small part in saving the planet. Put it all together and it makes a pretty compelling bull case.

There's really only been one stock that hasn't participated in this trend, a little-known renewable energy company that likely hasn't hit your radar. Here's why you need to start paying attention to this operator.

A niche player

Some critics argue that **Pinnacle Renewable Energy** (TSX:PL) shouldn't even be allowed to have the word in its name.

Pinnacle makes tiny wood pellets out of waste products from the lumber industry. The pellets are produced, dried to the perfect moisture content, and then shipped overseas to be burned for energy.

Thanks to what critics say are loopholes in the *Paris Climate Change* agreement, this is considered a renewable energy source. After all, trees can always be replanted.

Personally, I disagree with the naysayers. This is a great way to put a normal waste product to a higher use. Many wood waste products are burned anyway.

And yes, burning wood releases carbon into the atmosphere, but the tree that produced that wood sucked up carbon dioxide for years.

It appears that governments worldwide agree with my assessment, too. Areas such as Europe, the United Kingdom, and Japan are embracing wood pellets as a eco-friendly fuel, something that's helping Pinnacle expand at a pretty quick pace.

In fact, the company has contracts signed for 109% of its current production; it'll be able to achieve that production next year when a plant expansion comes online.

The company estimates global industrial wood pellet demand will increase from approximately 17 million metric tons in 2018 to 29 million metric tons in 2022 and then 35 million metric tons in 2026. Current worldwide capacity, meanwhile, is a little over 22 million metric tons.

While the long-term story continues to look good, Pinnacle's 2019 results have been weighed down by temporary issues hitting the British Columbia forestry industry, which reduced its waste wood supply.

On September 30, Pinnacle told investors these short-term issues would impact its earnings for the year, as margins get decreased because of the increased cost of raw materials.

Investors took it on the chin, with shares falling close to 50%. While the stock has since rallied, shares are still significantly below September highs.

The opportunity

Pinnacle is a growing player trading at a [deep-value valuation](#).

In 2018, the company generated \$32.2 million in free cash flow. Shares have a current market cap of just \$305 million, putting shares at under 10 times trailing free cash flow.

Investors should remember Pinnacle produced a little over 1.5 billion metric tons of pellets in 2018. 2019's production should be closer to two billion metric tons, and capacity going forward should be in the 2.5 billion metric tons range. Analysts expect 2020's revenue to be some 20% higher than this year's number.

In other words, free cash flow should head sharply higher once input pricing returns to more normal levels.

Investors are also getting a nice dividend as a consolation prize for waiting. Pinnacle shares pay \$0.15 per share each quarter, a payout that works out to a 6.7% yield.

The bottom line

2020 could be a pretty good year for Pinnacle Renewable. The company is expanding quickly, will likely generate plenty of free cash flow, and should continue to benefit from the long-term bull market in pellets. And investors get paid handsomely to wait. What's not to like here?

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